The Economist

JUNE 20TH–26TH 1992

QUAYLE'S PITCH page 29

DOG DAYS AT LLOYD'S pages 15 and 71

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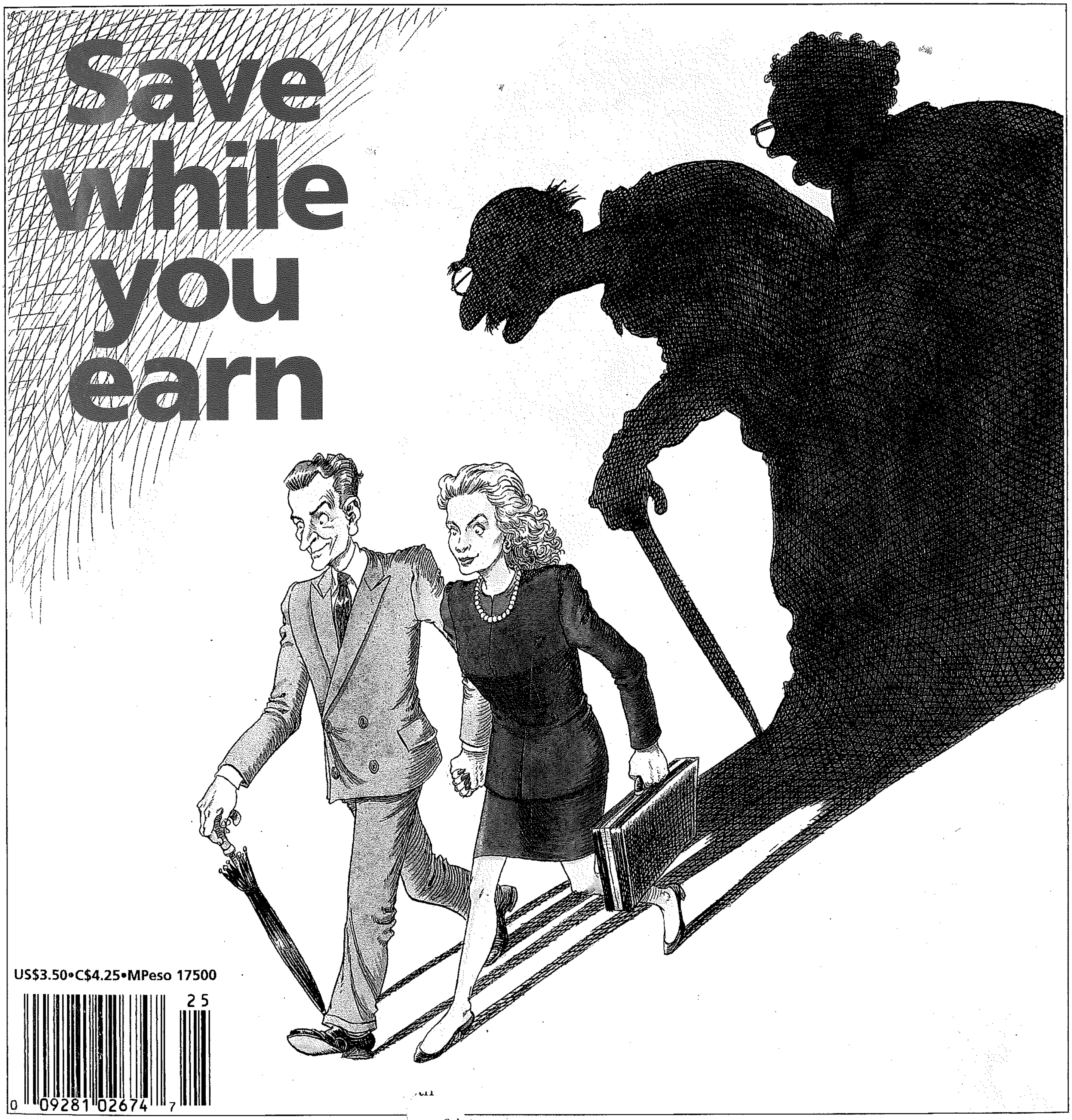
WHEN COMPUTERS MERGE pages 85-88



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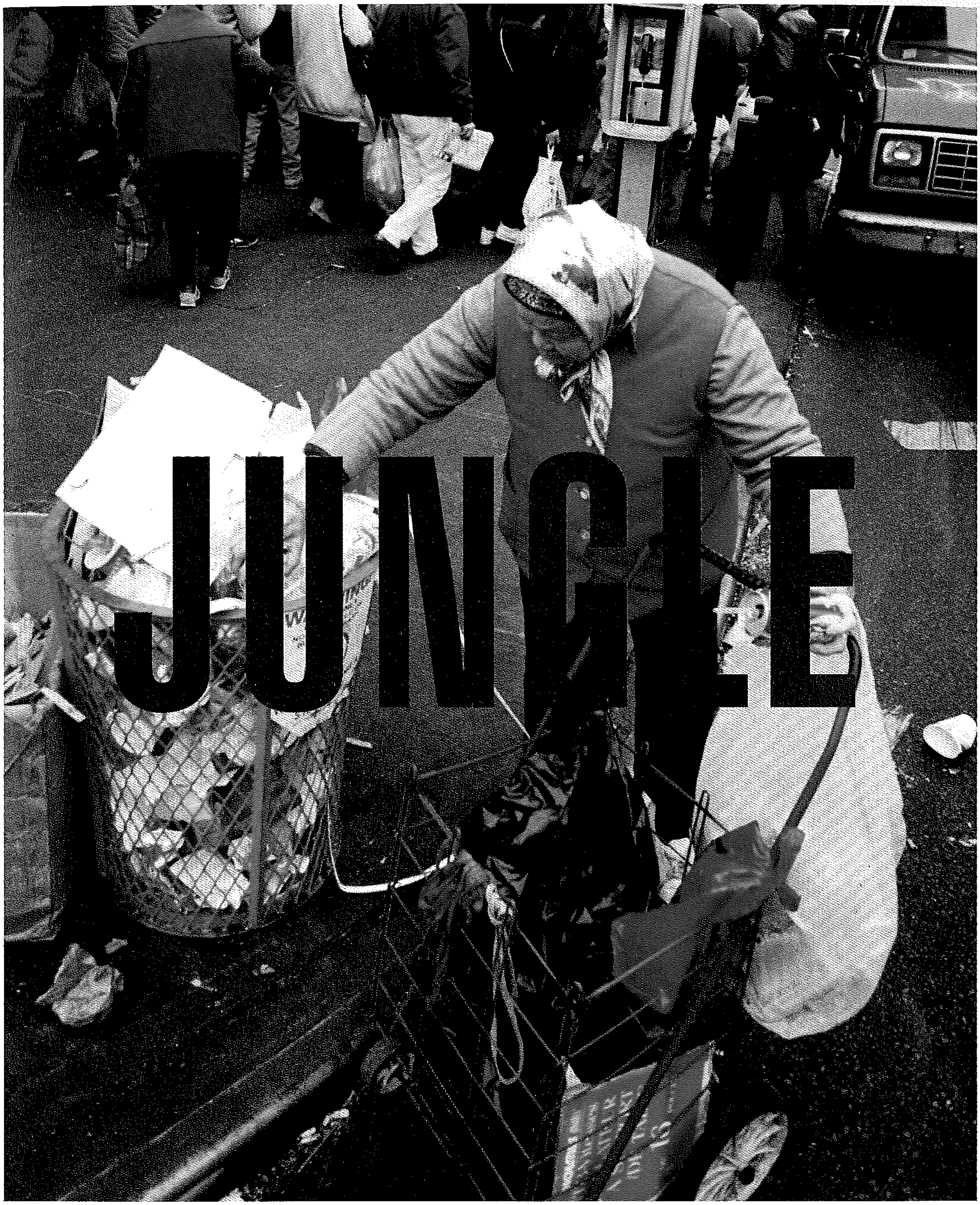


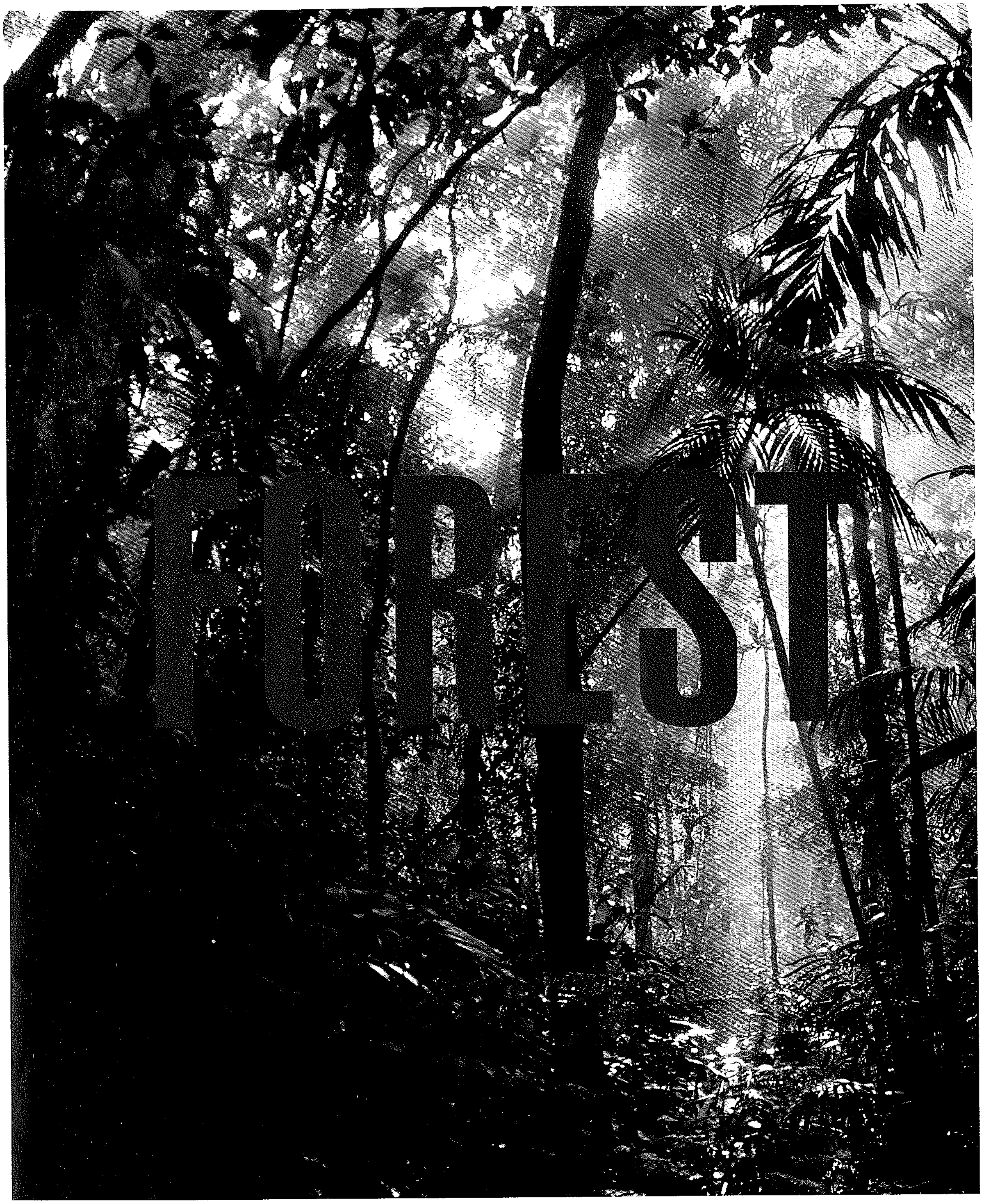
It is true that modern society possesses technological skills and powers which are beyond comparison.

But are they still beyond doubt? In terms of ways and means nearly anything is possible. Regarding our social and cultural environment, however, we rush headlong down a track that might well lead into a dead end - unless we are able to rethink what we call progress, to reverify the quality of life, to redefine our goals for the future.

For example by opening up within our dominant culture to other cultures, with other solutions for the balance both between man and man and between man and earth.

Maybe that can help us to redefine our gains and losses.

Origin: Amsterdam, Barcelona, Bombay, Brussels, Cambridge, Chicago, Cincin[illegible]us, Dallas, Dortmund, Eindhoven, Hamburg, Kaohsiung, London, Luxemburg,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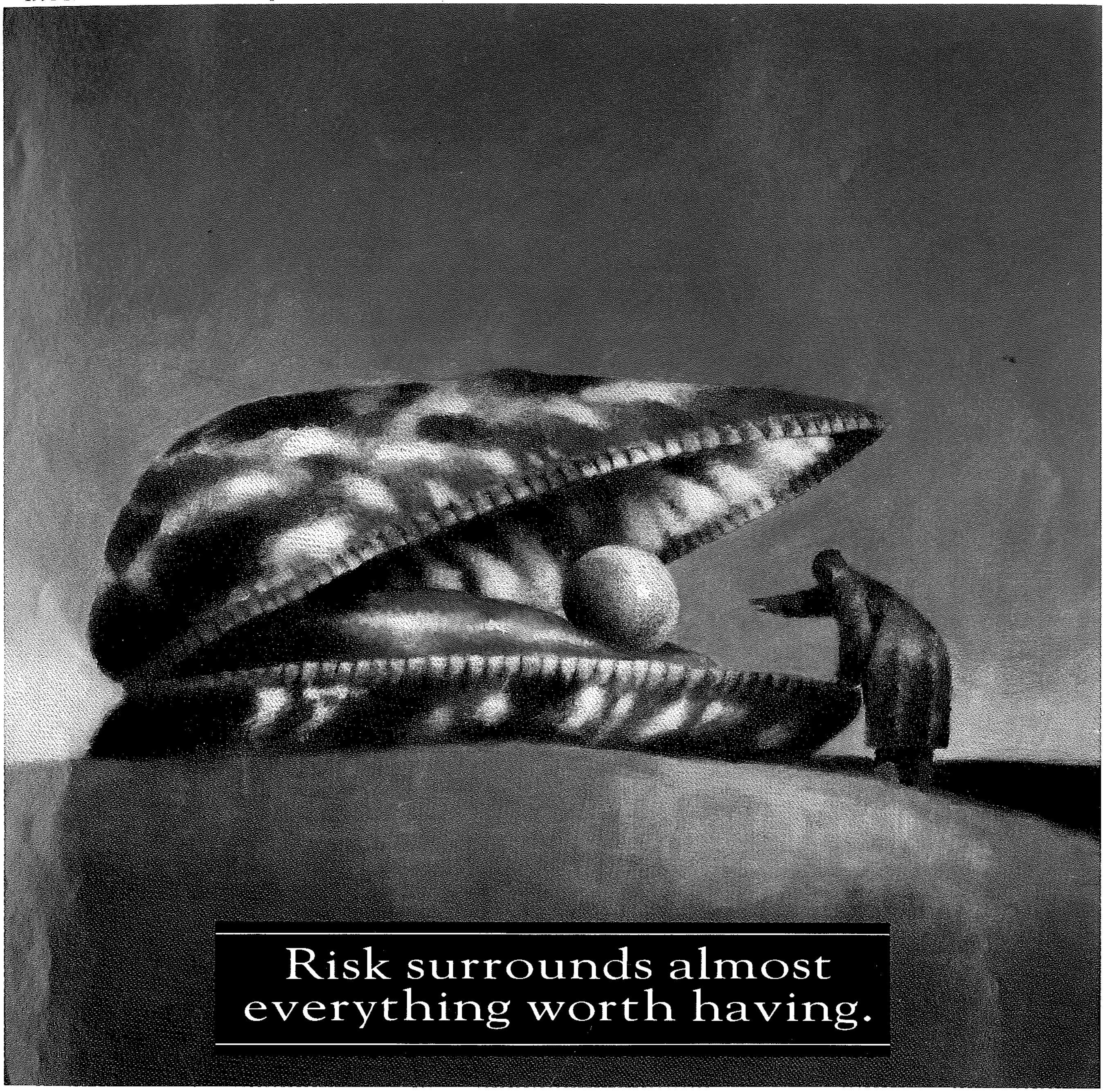

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The Economist
VOLUME 323
NUMBER 7764

JUNE 20TH 1992

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The Economist

FIRST PUBLISHED IN SEPTEMBER 1843

to take part in "a severe contest between intelligence, which presses forward, and an unworthy, timid ignorance obstructing our progress."

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LETTERS

The Economist Newspaper, 25 St James's Street, London SW1A 1HG
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Yugoslav shambles

SIR—Your argument against the international use of force in former Yugoslavia seems to suggest that economic sanctions alone might restrain Serbian ambitions ("Operation Balkan Storm?", May 30th). Whether they do or not, a lasting settlement surely requires a more comprehensive approach.

It is easy to abhor border changes, creation of enclaves and population transfers as intrinsically destabilising. In Yugoslav conditions, however, they alone can eventually induce stability, albeit fragile, provided they are managed internationally and accompanied by verifiable demilitarisation. A standing conference on Yugoslavia under the auspices of the United Nations appears to be sorely needed. Simplistic as it no doubt is, a land-for-peace proposition represents the only alternative to a festering wound. If foreign force is necessary, it should be applied only within the larger framework of a peace in which maps will be redrawn and coercive capabilities diminished. Someone should put a rational and forward-looking agenda on the table.

Heilsbronn, Germany VLADIMIR KUSIN

SIR—It is true that no military commander, UN, NATO, Western European Union or whatever, in his right mind would launch a land operation now into the mess that was once Yugoslavia. However, since Serbia has been recognised (at last) as the primary cause of the continued conflict, why not selective air strikes against the bases of the Yugoslav air force; units of the Yugoslav navy currently bombarding Croatian coastal towns; and Yugoslav army artillery currently active in shelling Sarajevo, Dubrovnik and other civilian centres.

The Balkan problem will be solved only by persistent pressure on those who are clearly the aggressors. Even the threat of action would concentrate the minds of those aggressors.

Walchwil, Switzerland D.B. HARLEY

SIR—Your comment (May 16th) that Croatia has "lost control of perhaps a third of its territory" is misleading. Much of the Serb-occupied territory within Croatia's present borders has been populated by Serbs for centuries and, before 1941, was never considered part of Croatia.

The Serb-Croat conflict is a dispute over territory populated by Serbs. To the Serbs in enclaves such as Krajina, the UN's mission is to guarantee them autonomy and protect them from Croat persecution. According to Helsinki Watch, the Croatian government has been summarily executing ethnic Serbs, torturing detainees, taking hostages and destroying property. Under no circumstances will the Krajina Serbs disarm voluntarily.

Germany bullied its EC partners into implementing policies that have only fuelled the conflict in the former Yugoslav republics. The EC offer of recognition to Bosnia, subject to a referendum, set the stage for a confrontation. Nationalists seized the opportunity to fan the flames of ethnic hatred between Bosnia's Croats, Muslims and Serbs. Bosnian independence violated the rule that major decisions in multi-ethnic societies must be by consensus, not by a simple majority vote.

London GEORGE TINTOR

SIR—People ask why the world does not attack Belgrade over Serbia's and the Yugoslav army's aggression against Bosnia and Croatia, as it attacked Iraq for its aggression against Kuwait.

It is easy to answer that question. Croatia and Bosnia have to suffer because they are not as oil-rich as Kuwait. What is worse, for a while it was in the interest of the United States to support Mikhail Gorbachev by not letting the Soviet Union fall apart too soon. As a model, "Yugoslavia" had to be kept together. Hence a paradox: communist Serbia got western support against sovereign democratic countries (Slovenia, Croatia, Bosnia and I hope soon, Macedonia). Such a policy of pretending to see no difference between the aggressor and the attacked encouraged Serbia to try to take as much of Croatian (and now Bosnian) territory as possible before "Yugoslavia" disintegrated.

In the end, the EC, America and the UN will be obliged to see that there is only one way to stop the "great Serbian" communist regime and Slobodan Milosevic, and that is to use force. It will also be realised that there is an obligation to act in all cases alike, not just in the lucrative ones like Kuwait, if a consistent and principled policy of keeping world peace is to be followed.

Zagreb, Croatia BORIS RADOVAN

Short-sighted Summers

SIR—Lawrence Summers is right (May 30th) to stress that cost-benefit analysis provides the correct framework for evaluating environmental investments. He was right to argue against using specially low discount rates. However, he fails to distinguish between the sensible mathematics used in current cost-benefit analysis and the questionable procedures used to assign dollar values to costs and benefits where the environment is affected.

Mr Summers is short-sighted. He evaluates global climate change by measuring its effect on growth, as though each dollar gained by rich northern countries that become more temperate is of equal value to a dollar lost by poor equatorial countries that grow even hotter. The anguish of a malnourished, pregnant mother sweating to eke a crop from soil of diminishing quality is not captured in GNP.

The welfare weights expressed in market prices are skewed in favour of the rich and against the poor and the unborn. They also fail to describe the value of untraded goods (as you noted in your economics focus of May 9th). When an economy is distorted by taxes and barriers to trade, economists calculate "shadow prices" to express the social, as opposed to market, value of goods. Environmentalists, geographers, anthropologists and economists should together construct environmentally and distributionally sensitive shadow prices for a litre of petrol, a rainforest tree, and a lovely mountain view.

Princeton, New Jersey PAUL CLEMENTS

SIR—Of course, Mr Summers is right when he concedes that the Bank's infamous record on the environment results from incorrect environmental costs being entered into project analyses. But what chance of getting it right in future? His own crass statements prove how easy it is to continue to miss the point by undervaluing benefits and over-estimating costs of environmental resources. Please recruit more world-class ecologists, Mr Summers—before it is too late.

Cambridge RICHARD ADEY

Pakistan's clean money

SIR—You give a misleading account of Pakistan's exchange and payments liberalisation (April 25th) introduced a little over a year ago.

One of the reforms was to permit Pakistanis to operate foreign-currency accounts in Pakistan. You refer to a presidential decree

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which permits banks to offer complete secrecy for foreign-currency accounts. It is alleged that drug money can thus be attracted to Pakistani bank accounts. This is not correct. As a part of the regulations introduced by the central bank in January this year, all Pakistani banks are required to guard against the use of banking channels for "money laundering and other trades."

One of the objectives of the reform in foreign currencies is to encourage Pakistanis to keep their holdings in Pakistan. Immunity is now offered against tax or related inquiries, as follows: "All citizens of Pakistan resident in or outside Pakistan who hold foreign-currency accounts in or outside Pakistan and all other persons who hold such accounts, shall continue to enjoy immunity against any inquiry from the Income Tax Department or any other taxation authority as to the source of financing of the foreign-currency accounts." These provisions do not in any way preclude law-enforcing authorities from investigating and indicating any illegal transaction.

MOHAMMAD AKRAM MALIK
Minister (Economic)
High Commission
London for Pakistan

Buoyant private schools

SIR—It would be surprising if the worst British recession in the memory of most people had not had some effect on people's ability to pay school fees (June 6th). The remarkable fact is that, in Headmasters' Conference schools at least, the number of children increased last year and the day schools are reporting healthy entry lists for September. You point out that our schools are investing heavily to improve facilities—not the usual response of institutions going bust.

It is wrong to present the suggestion of the Independent Schools Information Service that independent schools should be allowed to opt into the grant-maintained sector as a desperate last fling for survival. Some schools heard discussing this idea are the city day schools which enjoy the healthiest position. They have long traditions of close links with their localities and pride themselves on taking children from all walks of life. It is their wish to make the education they provide even more widely available which motivates their thinking. This would seem to be in line with a policy "to blur the distinction between public and private sectors" and to provide parents with choice even less restricted by ability to pay.

VIVIAN ANTHONY
Leicester Headmasters' Conference

After the fiesta

SIR—In your excellent survey of Spain (April 25th), you say Spain "can go further", among other things, in its participation in United Nations peacekeeping. In fact, since 1989 Spain has increased its financial contribution to the UN budget for peacekeeping operations by 400%, and is now the ninth-largest contributor to this budget.

Spain has participated in UNAVEM I (Angola), UNTAG (Namibia), ONUCA (Central America), ONUVEN (Nicaragua), ONUVEH (Haiti), and is currently participating in UNAVEM II (Angola) and ONUSAL (El Salvador). We also provide technical and logistic assistance to MINURSO (Western Sahara) and have contributed to the Fund for the Repatriation of Refugees established in the context of this operation.

Indeed, our co-operation with the UN in the field of peacekeeping has increased dramatically over the past two years. It now includes contributions of substantial contingents of observers from the Guardia Civil and the Policia Nacional as well as civilian personnel, military equipment, logistic support and humanitarian assistance.

JUAN YANEZ-BARNUEVO
New York Ambassador to the UN

SIR—You note that Spaniards probably get less sleep than other Europeans, but then suggest facile explanations such as "super-achieving." The true answer is that Spaniards don't know the time.

People know where Spain is, but do not draw the necessary conclusions about Spanish time. Seville, for example, is almost due south of Dublin, yet Spain observes the same Mitteleuropean clock-time as Berlin, when it should rationally keep the same time as Dublin, London and Lisbon (as well as the Canaries).

That did not matter in pre-industrial, pastoral Spain, since life moved with the sun, and clocks could be ignored. But in a modern industrial state, clock-time is all important and the result is a national schizophrenia about the time of day. Many shops and offices do not open until 10am, and are still open at 7 or 8pm. Most industries working normal western hours have employees yawning through the morning sessions, since they were up until well after midnight.

It would be fine to see a sensible Iberian time adopted in the year that celebrates the geographical uniqueness of the Iberian peninsula; a uniqueness that gave it such a head-start in the discovery and development of the Americas out to the west.

Malaga ROSS PIERSON

Lattimore's failure

SIR—Your review of Robert Newman's book about Owen Lattimore (May 23rd) is too kind to both author and subject. Lattimore was neither a spy nor a communist, as Joseph McCarthy accused him of being. However, as the West's foremost authority on Mongolia, with privileged access to the country, Lattimore ignored the disaster which overtook the Mongols in Mongolia, in China and the Soviet Union. On Stalin's orders, about 100,000 people, mostly lamas, were murdered during the purges of the 1930s in Mongolia, including state leaders who refused to order the destruction of the monasteries. A similar massacre overtook Tuva and Buryatia.

Lattimore believed the Mongolians were running their own show when, in fact, anything of any importance was done only under the instructions of the Soviets. In addition he paid little attention to the fate of China's Mongols. Up to 800,000 were arrested and tortured during the cultural revolution when Mao Zedong tried to smash the Mongolian ethnic identity. Why was an admired scholar, who clearly cared deeply about the Mongols, so utterly taken in by appearances?

London JASPER BECKER

Success and value

SIR—Your management focus on John Kotter's and James Heskett's research into the importance of strong corporate cultures (June 6th) demonstrates real understanding of the issues.

In the short term, a company can deliver value to shareholders by squeezing the value it delivers to employees or customers. But a company can deliver more value to all its stakeholders only if it is a strong business capable of outperforming its competitors. Successful companies can create value for all stakeholder groups. Unsuccessful companies have to short-change one or more stakeholder groups in an attempt to survive. Hence performance is best measured by looking at the value created for all stakeholder groups, not just shareholders.

You are right to criticise Messrs Kotter and Heskett for "suspiciously circular" research. By comparing analyst ratings of how much a company values its customers, shareholders and employees with the company's record of delivery to each stakeholder group, the authors are correlating success with success, and failure with failure. They are not adding to knowledge.

ANDREW CAMPBELL
Ashridge Strategic
London Management Centre

Hope-sahib

SIR—Lexington refers to Bob Hope "seeming not quite 12 annas to the rupee" (May 23rd). Apart from wondering why Bob Hope should be associated with an Asian currency, surely it should be 16 annas to the rupee. Am I missing something or is your reporter himself "not quite 16 annas to the rupee"?

Lutong,
Sarawak DAVID COOKE

VACANCY NOTICE
Interim Director General of the Regional African Satellite Communications System (RASCOM)

The position described below is to be filled in the executive organ of a recently established commercial African Satellite Organization based in Abidjan, Cote d'Ivoire.

Position: Interim Director General.

Job function: Under the direction of the Board of Directors of the RASCOM Organization, the Director General shall have the following main responsibilities.

INTERIM DIRECTOR GENERAL OF RASCOM

Main responsibilities:

- To ensure the setting-up of RASCOM Organization including making appropriate appointments for the RASCOM establishment;
- To ensure that the organization is run according to the Convention and Operating Agreement;
- To ensure overall discharge of all operational matters relating to both terrestrial and space segment needs of the Organization;
- To assume the responsibility for all public relation matters of the Organization;
- Ensure the implementation of the decisions adopted by RASCOM Board of Directors;
- Representations of the executive organ at the meetings of the Board of Directors;
- Ensuring the successful implementation of contracts in accordance with the directives of the Board and other guidelines that may be applicable;
- Act as legal representative of the RASCOM Organization with authority to sign contracts and appropriate agreements in accordance with established procedures;
- Ensure financial discipline in accordance with the established financial procedures and directives of the Board;
- To oversee all matters relating to the staff;
- To perform any other assignment that may be entrusted to him by the Board of Directors.

External contacts:

- Satellite systems providers;
- International telecommunications organizations;
- National telecommunications organizations;
- Financial institutions;
- Equipment manufacturers.

Required qualifications:

1. Advanced level degree in telecommunications or science-related fields. Post-graduate professional training in management would be an added advantage.
2. Suitable experience of at least 12 years in the field of telecommunications, including at least five years in high managerial level. International exposure can be an added advantage.
3. Excellent reputation, honesty and integrity, proven team builder coupled with leadership qualities.
4. Self-motivated, resourceful, excellent interpersonal skills, and organizational ability.
5. Excellent knowledge of either English or French. A good knowledge of the other language would be an added advantage.
6. Age not more than 55 years.
7. Applicant must be an African.

The RASCOM Organization

By decision and resolution RASCOM/02 of the Conference of African Ministers responsible for Telecommunications, Abidjan, May 1992, a regional African satellite organization is established with its Headquarters in Abidjan, Cote d'Ivoire.

The main objective of the organization shall be to provide on a commercial basis, and by the most economical means, the space segment required for national and intra-African public telecommunications services in Africa, which will form part of an integrated African telecommunications network.

The organization now seeks exceptional candidates to form the core team for its executive organ to take up the challenge of establishment of the organization from scratch.

Prospects for successful candidates are excellent including negotiable salaries and conditions of employment comparable to those in other similar international organizations.

The Vacancy Notice is open equally to men and women. Selection will be on the basis of a C.V. and an interview.

Directives

Candidatures should be submitted in two separate enclosed envelopes as follows:

1) The first envelope should contain:

- the application in manuscript addressed to the RASCOM Board of Governors;
- a detailed Curriculum Vitae based on U.N.D.P. (U.N.) personal history form.

N.B: This envelope should mandatorily bear the following: "Candidature for the post of the RASCOM Interim Director-General: to be opened only by the first meeting of the Board of Governors.

2) The second envelope in which the first envelope should be enclosed, should bear the following address and posted under registered cover;

Mr Y. C. Afanou,
Organization of African Unity,
P.O. Box 3243, Addis Ababa, ETHIOPIA

N.B: Candidatures should reach the above address by 30 October, 1992 at the latest.

Center for International Climate and Energy Research - Oslo (CICERO) is a Policy Research Foundation of the University of Oslo. CICERO is presently conducting and organizing policy research as well as more basic research with an interdisciplinary staff of 17. The center has been actively involved in the ongoing international scientific and negotiating process with regard to climate change.

CICERO

To lead CICERO's group of economists the position is open as

Chief Economist

Applications are invited for a permanent position as Chief Economist at CICERO. Applicants should have a Ph. D. in economics and have published widely on relevant items, e.g. resource and energy economics, environmental economics or international economics. The center is looking for applicants with proven experience of empirical research, as well as theoretical ability.

CICERO is an equal opportunity employer.

Commencing salary per annum will be in the range of NOK 370 000 to 403 000 (GBP 30,050 - 35,300). For candidates with an outstanding background a contract appointment with higher salary could be negotiated.

Please contact CICERO, University of Oslo, phone 47-2-693177/695206, Ted Hanisch, Director or Professor Michael Hoel or by fax 47-2-856284 for further information.

Applications should be sent to CICERO, P.O. Box 1066 Blindern, N-0316 Oslo, Norway. Closing date is 30 July 1992.

AQUACULTURE PROJECT DIRECTOR,MALAWI

The International Center for Living Aquatic Resources Management (**ICLARM**) is an international organization conducting interdisciplinary research on aquaculture and fisheries in tropical developing countries. The Consultative Group on International Agricultural Research (CGIAR) has recently accepted **ICLARM** to become an international center for fisheries research under its umbrella. **ICLARM's** research is carried out in close cooperation with national programs.

The position is based at Malawi's National Aquaculture Centre near Zomba, with occasional travel throughout Malawi, to other African countries and to **ICLARM** headquarters. Main duties include: 1) managing and directing a collaborative research and training program involving **ICLARM**, the Malawi Fisheries Department, the University of Malawi and the Malawi Department of Research and Environmental Affairs; 2) assisting **ICLARM** and its collaborators with the development of collaborative research linkages in inland aquaculture research and development, principally in southern Africa.

The candidate must have a Ph. D. in aquaculture or related field and be fluent in English. Preference will be given to candidates with extensive experience in managing aquaculture research projects and working with national programs, preferably in sub-Saharan Africa.

ICLARM wishes to fill this position by 1 November 1992. Applicants are invited to send their curricula vitae, date of availability, names and addresses of three referees (including telephone, telex or Fax numbers) and copies of relevant publications to: **Director General, ICLARM,** MC P.O. Box 1501, Makati, Metro Manila, Philippines; Telex: 64794 ICLARM PN or 4900010376 ICL UI (USA); Fax: (63-2)816-3183. *Deadline for receipt of applications is 15 July 1992.*

Regional Behavioral Science Advisor for Program Impact (RBSAPI)

Basic Function of Position: As a Regional Behavioral Science Advisor specializing in monitoring, evaluation, and reporting on program progress and impact, the incumbent shall provide host country governments, universities, NGOs, and A.I.D. Missions in the 20 countries of East and Southern Africa and the Indian Ocean States with technical expertise. This technical assistance will include a range of consultative, advisory, information-gathering, analytical and evaluative responsibilities relating to the issues of performance monitoring and the assessment of program impact. The incumbent will build awareness of the importance of these issues and assist in the design and implementation of cost-effective systems to produce the kinds of information needed by decision-makers. The RBSAPI will report to the Chief, Analysis and Planning Division of USAID'S Regional Economic Development Services Office for East and Southern Africa (REDSO/ESA), which is located in Nairobi, Kenya.

Major Duties and Responsibilities: Based on the incumbent's knowledge of cultural, social, economic, and political aspects of development in the ESA Region, he/she shall (A) serve as the behavioral science advisor on USAID project teams (tasks involve conceptualization and detailed planning for monitoring, evaluating, and reporting on the "people-level impact" of A.I.D. country programs, detailed planning of activity performance monitoring systems, and the implementation and evaluation of baseline surveys, rapid reconnaissance surveys, tracer studies, intermittent panel surveys, opinion polls, and other social/economic assessment methodologies as appropriate), (B) participate in training staff involved with performance monitoring, evaluation, and reporting systems, (C) ensure that A.I.D. systems incorporate information already generated by other donors and organizations, (D) perform analytical tasks such as assessing the constraints (and possible solutions) to effective monitoring and evaluation of development programs and activities in the ESA Region, assessing the potential for employing more efficient and powerful methods for empirical data-gathering, analysis, and reporting than those currently employed, and assessing case studies from ESA which can illustrate innovative and effective ways of development impact monitoring and reporting, and (E) overall, ensure that USAID information systems are conceptually sound, thorough, cost-effective, and user-friendly. Generally, the incumbent will spend 90% of time on substantive tasks and no more than 10% of time on A.I.D. administrative tasks.

Minimum Qualifications: Must possess an advanced degree (PhD preferred) in a relevant discipline such as anthropology, economics (particularly micro-economics), or rural sociology. Academic work in advanced statistics and evaluation methodologies is highly desired. Must have five years of prior experience as an applied behavioral scientist, including design and management of project evaluation systems and conducting independent research studies involving primary data. Preference will be given to people with ten or more years of experience in development fields, particularly if it includes A.I.D. projects or employment. Must have two years of prior experience in Africa, either long-term or through substantive short-term assignments. Preference will be given for experience in ESA Region. Must be fluent in English and have proven ability to communicate quickly, clearly, and concisely in both speech and writing, including technical reports. Fluency in French and/or Kiswahili is highly desirable. Prior experience in questionnaire design involving translation into various languages is also desirable. Must have a thorough professional knowledge regarding the collection and use of empirical information for monitoring and evaluating the impact of socio-economic development efforts. Must be willing to learn relevant A.I.D. procedures and regulations. Substantial computer skills are required, including the need to use basic statistical packages like SAS or SPSS, doing spreadsheets, using word processing software and quickly entering own data into a computer system.

USAID contemplates awarding a Personal Services Contract on about 15 August 1992. It will likely be for a two year term with an option for extension. The selected individual must obtain security and medical clearances which include a physician's certification that the individual and any accompanying dependents are medically fit to serve in the African environment. A.I.D. encourages the participation to the maximum extent possible of women and minority individuals in this activity, in accordance with Part 19 of the Federal Acquisition Regulations. By July 17, 1992, qualified individuals are requested to submit applications including SF-171 (available from U.S. Post Offices and USAID Missions), resume, and salary history to Contracting Officer for RPSAPI, USAID/REDSO/ESA/CON. The mail address is Unit 64102, APO, AE 09831-4102, and the fax number is 254-2-330945 or 337304. Selection will be based on an evaluation by a Technical Evaluation Committee of the applicants' qualifications.

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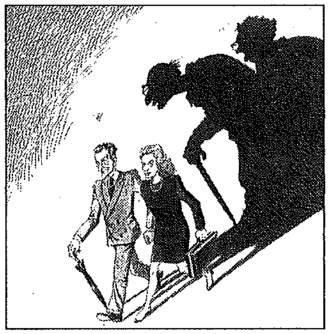
Save while you earn

DESPITE all the changes in attitudes in the world's rich countries over the past 40 years, one powerful prejudice shows few signs of decay. It is the idea that people in retirement are "dependants". One way or another, it is presumed, today's workers must support their unproductive forebears. That is patronising nonsense, and is well on the way to becoming dangerous nonsense too.



If demographers know their business, the balance of population in today's rich countries will shift a lot during the next 30-40 years. The baby-boomers who were born in 1945-65 will retire. Since they outnumber their children, the "dependency ratio" will rise, in some cases sharply (see pages 19-21). This will put great strain on the pension systems that have grown up since the second world war. Governments have got only ten years or so to head off that strain. Given their penchant for dynamic action on difficult issues, that means it is probably already too late.

Shall I part my hair behind?

Demography is an inexact science. Population forecasts for the distant future (say, 2050 and beyond) are not much use, because too few of the people who will be alive then are alive now, and birth rates change. But it is easy to see 20 years ahead, and it is then that the ratio of retired people to working people will rise. In some countries, taxes will have to rise steeply to pay for the state pensions that today's workers are being led to expect they will receive in retirement. Higher taxes will blunt incentives and reduce economic growth, further narrowing the base from which taxes are gathered—a vicious circle. As for private pension schemes, the flow of saving into bond and equity markets will dwindle. That will put upward pressure on real interest rates, threatening growth and living standards in another way.

A crucial question, then, is this: how should people in affluent societies prepare themselves financially for retirement? Too few people ask it, and that is a large part of the difficulty.

Some expect to rely on their pensions from the state. In most rich countries, after all, workers are told that part of the tax they pay is a "contribution" to the social-security system, a down-payment on their pensions. In fact, this is a con. Almost all governments finance state pensions on a pay-as-you-go basis, raising current revenue to cover current spending. That is precisely why, when the tax bill for pensions starts to mount, governments may be tempted to curb benefits—and pensioners, feeling cheated, will howl back in anger.

Company pension schemes cater for fewer people than the state systems do, but when they go wrong it is often a bigger disaster. In some countries, company schemes own few financial assets to back their future liabilities; they are, in the jargon, "unfunded". In effect, contributions have been invested in the company itself. If the company fails, so will the pension scheme. Funded schemes have outside assets, but it is often unclear who owns them. Never mind cases of outright theft such as the Maxwell fraud; in many countries firms can draw down pension-fund surpluses (ie, assets in excess of what actuaries say will be needed to meet future liabilities) entirely legally. Surpluses might be used to reduce contributions paid by today's employees—rather than, for instance, to provide full inflation-proofing of benefits for today's retirees. In America, investors have even acquired companies chiefly in order to strip their pension-fund surpluses.

Surpluses can arise because, in most countries, the defined-benefit pension scheme has been the norm. It promises to pay a certain pension, regardless of the cash paid in or the returns generated over the years. In its most extreme form, the pure final-salary scheme (under which the defined benefit is some multiple, depending on years in the scheme, of the pensioner's final salary) can and does yield outrageous results.

Consider two employees with identical career-histories. Except that one, a friend of the chairman, has his salary doubled in his last year before retirement. The value of his pension is doubled at a stroke, though the contributions paid during his career will hardly differ from those of his colleague. In less outlandish cases, the final-salary scheme penalises job-changers—even if the pension's transfer value (the sum available to be paid into another scheme) is actuarially "fair" (which it often is not). Even with fair transfers, each move reduces the weight that will be attached to the pensioner's high-income years.

This familiar pair of pensions—the pay-as-you-go state scheme that pretends to be funded, the defined-benefit company pension with all its uncertainties and anomalies—reflects the dependency myth. Old people must be—nay, are entitled to be—looked after by the state. And "good" employers want to do more. With massive tax breaks for encouragement, they offer their retired former employees a comfortable standard of living—on the company's terms. Both approaches are wrong. Responsibility for saving for retirement should rest not with the government, nor with employers, but with the individual. That principle points to quite different conclusions.

State pensions should not be thought of as a universal entitlement, but as part of society's safety net: they should be paid only to those in need. Company-provided pensions should be deprived of their tax advantages, and left to fade away. And all savings of individuals should be tax-exempt. (This accords with the principle of tax-neutrality because, under conventional income-tax systems, savings are taxed twice.)

Narrowing the scope of state pensions would enable gov-

ernments to lower taxes; removing the tax incentive for company pension schemes would encourage firms to pay employees more cash rather than make fallible promises of income in retirement; out of those bigger post-tax salaries, people would have every reason to save more. With this system, moreover, there is no place for a state-mandated retirement age. Many employees might choose to work longer. Remembering the predicted demographic crunch, their employers would be glad to have them. In any event, retirees-to-be would face a less uncertain future. It would be in their own hands, not in those of governments (which may find the fiscal burden overwhelming) or employers (who are both fickle and accident-prone).

Getting there

This alternative system is easier to sketch than create—and that is putting it mildly. For people who have already retired, and those who are about to, it is too late to change the rules. Apart from the transitional difficulties (which would vary, according to country, from formidable to nearly insurmountable), there is another problem: the near-universal reluctance to engage in pensions reform of any sort, under any circumstances. America's relatively prosperous pensioners, for example, are enraged even by the suggestion that their social-security payments should be taxed as if they were income (which, of course, they are). Imagine the uproar if a presidential candidate mooted the idea that, albeit sometime next century, social-security payments would be means-tested.

However, once policy-makers are convinced that demographic difficulties lie ahead, and that radical pensions reform is needed, they can at least start inching that way. Steps towards neutrality in the taxation of savings are easy to take, and desirable in any case. Vigorous promotion of personal, portable pensions ought to be a vote-winner. So too ought tougher regulation of company pensions schemes, in ways that coincidentally diminish their appeal to corporate treasurers. Limiting increases in state pensions to the rise in prices rather than to the rise in earnings will gradually erode their attraction.

With measures of this sort, consistently pursued, the rich countries' pension systems might one day end up in the right place. And, you never know, it might even happen in time.

The case for Yeltsin

Russian economic reform is still worth supporting

THE agreement between Boris Yeltsin and George Bush to slash strategic arms is welcome and remarkable (see page 24). But it is only a first step in a longer process: the attempt to integrate Russia into the world of free-market democracies. A poor and unstable Russia, even with fewer weapons, remains a threat to the world's stability—and a greater one, perhaps, than was the stable but heavily armed Soviet Union. Without a functioning market economy, Russia's democracy will remain vulnerable to those who would reverse both arms agreements and economic reform.

Reducing weapons will be a picnic compared with rebuilding Russia's economy. Here, the outlook has turned gloomier. In the past few weeks Mr Yeltsin's government has loosened control over the printing of money even though Russia is near, if not already in, hyperinflation. It is offering cheap loans to bail out enterprises whose managers want to kill the reforms. And, to multiply that error, Mr Yeltsin has welcomed into government three industrial representatives, who will doubtless clamp a restraining hand on the levers of change. On top of all that, he has angered the International Monetary Fund by postponing, possibly for as much as a year, the next crucial economic change: the freeing of domestic oil prices.

To pay, or not to pay?

Russia is now likely to miss many of the targets it promised to meet in its "memorandum of understanding" with the IMF, signed in February (see page 63). Unsurprisingly, th IMF is wondering whether to block loans that Russia expects to draw as a member and, if necessary, the $24 billion in aid promised by western countries in April. Mr Yeltsin replies that it is the IMF which should change, not Russia—a line the Fund has heard from many actual and would-be basket-cases down the years. Mr Yeltsin, however, has clout, and he knows it. He hopes Mr Bush will use America's influence over the Fund and its G7 partners to continue to support Russia's reforms.

It hardly needs saying that Russia is not just another third-world supplicant—witness the strategic-arms agreement. Aid that keeps in power a leader who is friendly to the West, or that reduces the risk of instability that may later spread, is amply justified. To insist on strict policy conditions before giving aid is not to deny these obvious truths, but simply to point out that aid will surely fail to achieve stability, or anything else, unless the economy is radically reformed. That is why it is essential to look closely and sceptically at Mr Yeltsin's recent actions.

On the face of it, the case for the defence is weak. The decision to loosen monetary control is a bad mistake. It threatens Russia with higher inflation and a deeper recession than it has already; no small achievement. The decision to postpone oil-price rises is also a mistake. It will spur labour unrest in the oil-producing regions and delay economic adjustment—all to keep alive gas-guzzling industries that should be shut down in any case.

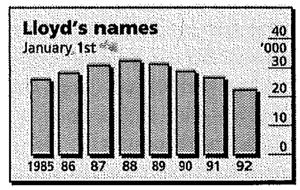
However, the reforms are far from dead. Oil prices are still planned to rise sharply this year, though not in a once-and-for-all jump as big as the IMF wants. Nor should it be assumed that Russia's relaxation of macroeconomic policy will be carried any further. Yegor Gaidar, the architect of the reforms, says he will tighten up again later this year. That claim should not be dismissed lightly. Several times in the past, Mr Yeltsin and Mr Gaidar have proved—through actions, not words—that they are radical reformers. Mr Yeltsin has strengthened the controversial Mr Gaidar by making him prime minister. That was a signal to reactionaries in parliament that there is a limit to compromise on economic reform.

Moreover, after the first cavalry charge at reform—freeing prices and raising interest rates—Russia is now entering a stage

in which deeper changes have to be made, especially to the ownership of firms. Things will go more smoothly if managers can be persuaded, rather than coerced, into changing their ways. If the government's tactics fail to keep reform moving forward, Mr Yeltsin will need to think again. Then will come the make-or-break point for his revolution. For the moment, however, it is inevitable that the government will, at best, tack towards its goal, rather than move there in one smooth motion.

And, for all its recent setbacks, the government continues to make progress in ways that would have seemed unthinkable two years ago. It remains committed to unification of Russia's multiple exchange rates on July 1st. It has pushed its privatisation proposals through parliament: vouchers for buying shares in state property are to distributed by December. A stand-in for the new and much-needed bankruptcy code, rejected by parliament, has been created by presidential decree. This suggests that Mr Yeltsin's determination to push through the changes he believes are essential is undiminished. He has been brave, he is still being brave. Until that verdict changes, he deserves support.

Dog days at Lloyd's



To escape death by losses and litigation, Lloyd's of London needs to become a medium-sized insurance company

ON JUNE 24th the chairman of Lloyd's, David Coleridge, will announce a loss of £2 billion ($3.7 billion) for 1989, the most recent reporting year for the London insurance market. Another £1 billion-plus loss is expected for 1990. The bulk of these billions is hitting 5,000-odd "names" (the individuals who provide Lloyd's capital) on syndicates that specialised in excess-of-loss reinsurance against catastrophes. These distressed names do not think they are merely the victims of hurricanes, earthquakes and storms. They suspect underwriting negligence or worse, and many will sue rather than pay.

So the next few years look grim, which raises two questions: can Lloyd's survive, and would it matter if it didn't? Certainly Lloyd's is less significant, to world insurance and to the City of London, than it used to be. But it is still a leader in marine insurance, specialist reinsurance and the assessment of new risks such as satellites. These virtues are being swamped by the names' complaints and the market's wider problems. Lloyd's can survive, but only by becoming duller.

On the brink

For the past two months the council of Lloyd's has pondered spreading the losses more widely around the market. It has now decided that that would not work (see page 71). Names who think they can cover their losses through litigation are unwilling to give up their right to sue. Some have said they would consider a deal if they were left to pay only 10% of their losses—which would cost £1.4 billion for 1989 alone. On the other side, names who, by good luck or good judgment, avoided the syndicates that made heavy losses see no reason to breach Lloyd's 300-year tradition of unlimited liability by bailing out their fellows. They are already cross at having to provide an extra £500m over the next three years to boost Lloyd's central fund.

This intransigence is understandable. To meet losses of, say, more than 50% of distressed names' underwriting limits would cost £700m for 1989—around £35,000 for each of the other 20,000 names—and more in later years. Nor is there any other pot of gold to go for. The errors-and-omissions insurers who might have to pay for negligent underwriting have limited exposure—and most of them are Lloyd's names anyway. The market's underwriting agents and brokers say they have too little capital. Any notion of a loan or a levy to be charged against future profits would deter potential investors from risking their capital in Lloyd's.

Lloyd's has had tough times before. In 1965-67, losses totalled nearly 20% of premium income. But they were followed by 20 years of profit. True to this cyclical pattern, most insurance premiums have risen sharply in the past 12 months, so 1992 should be a profitable year. Yet Lloyd's is in worse trouble than in the 1960s. Its losses are bigger: 1989's alone come to nearly 20% of the market's premium income. They have come when the top personal tax rate against which names can offset losses is 40%, not 91%. Threats of massive litigation are also new. Names who are not, in effect, tied to Lloyd's because they have open years (for which the accounts cannot be closed) have been resigning in droves. And for the first time policy-holders are questioning the wisdom of putting business at Lloyd's.

To stay alive, therefore, the market will need to change radically. The recommendations in January's Rowland report—such as a compulsory high-level stop-loss for names, and trading in syndicate memberships—are merely a starting-point. Litigation, the hangover from the past and lower personal tax rates will make it desperately hard for Lloyd's to attract new capital from individuals. The market will have to draw in corporate capital, probably from commercial insurers.

The capital will come only if Lloyd's changes its management. Lloyd's has a structure of committees and bureaucrats that would do a government department proud (indeed, many staff are former civil servants). That is not good enough for an insurance market that requires tough management to fend off competitors. Lloyd's needs a full-time chairman with a supporting board of directors who are proven managers. They must cut the market's costs, including pay. In the 1960s Lloyd's had lower costs than most insurance companies; today the reverse is true. The market should also delegate its regulation to a public body such as the trade department.

Such changes would blur the distinction between Lloyd's and the insurance companies, but not abolish it. For instance, there is no reason for some individuals to stop being underwriting names, an arrangement that has tax advantages as well as allowing their capital to work twice. And the new-look Lloyd's would retain the underwriting expertise and brand name that it has built up over three centuries. For most of that time it has made bigger profits than the commercial insurers. If it could rediscover that habit, even a shrunken Lloyd's would have a future.

Toujours Delors?

The case for replacing the top Eurocrat

ONE of the few near-certainties in the European Community these days is that, at their Lisbon summit later this month, EC leaders will reappoint Jacques Delors to another spell as president of the European Commission. A pity. It is time for Mr Delors to go—though not for the reason that the likes of Britain's Bruges brigade have been baying for his blood.

Mr Delors has been the most successful boss the commission has had. Before taking the job in 1985, he identified an EC-wide market as the right policy to push; Project 1992 relaunched the Community. His five-year budget deal in 1988 ended the exhausting annual haggle and allowed minds to concentrate on the big issues, such as the single market and economic and monetary union (EMU). The 1989 Delors Report then set the agenda for EMU. Under his centralising rule, the commission itself shed some of its old inefficiency.

Above all, Mr Delors has been a font of ideas. Some (the 1992 project, EMU) were brilliant. Others (the EC's "social dimension" and, just before Denmark's fateful referendum, the notion of a beefed-up EC executive) were not. He was also full of ideas on federalism. In pushing so strongly for political union, it is now clear that he overreached himself.

Yet to blame the Maastricht mess on Mr Delors, as most of his detractors now do, is unfair. Maastricht is a treaty between governments, not a creation of the commission. It was urged along by President Mitterrand of France and Chancellor Kohl of Germany and signed by 12 consenting adults. The wrong reason for wanting Mr Delors to quit when his term runs out at the end of the year is that he is responsible for everything that has gone wrong. Indeed, making him the scapegoat might give the impression that the problem had been removed.

However, it is precisely because a lot has changed post-Denmark that Mr Delors is now the wrong man for the job. He represents continuity and centralisation at a time when the Community needs a fresh approach and a less power-hungry commission. To his credit, Mr Delors has nimbly repositioned himself as a champion of subsidiarity. The trouble is, few people believe he really means it. The idea of Delors as decentraliser somehow lacks credibility.

Send for Sutherland

So why is he about to be reappointed for a further two years? Partly because EC governments want to pretend that it is business as usual. They mumble about the absence of alternatives. Really? No one in the whole of the Community capable of taking over Mr Delors's job? True, if the only possibilities were the names now being put about—Frans Andriessen, the Dutch commissioner, and Martin Bangemann, the senior German commissioner—it would indeed be folly to dump Mr Delors. But alternatives can always be found. *The Economist*'s choice would be Peter Sutherland, who shone as competition commissioner from 1985 to 1989. Highly competent and more pragmatist than visionary, he would also, as an Irishman, return the presidency to a representative of a small EC country—surely a good idea, post-Denmark.

But EC leaders have another reason for sticking with Mr Delors. They are a cosy club and have all but agreed that one of their number—Holland's Ruud Lubbers—should have the top job at the commission next. He says he is not ready until 1994; so Mr Delors must stay for two years. That smacks of the sort of behind-closed-doors fix that the Danes voted against. Don't blame Mr Delors for that. He would be only too delighted to have his job decided by direct election, the federal way.

Israel's choice

May the best Yitzhak win

EVER since Israel conquered the West Bank and Gaza in the 1967 war, it has been putting off its Big Decision about what to do with them. At every election, foreign pundits have announced that Israel was approaching its moment of truth. The election due on June 23rd, a titanic duel between Yitzhaks Shamir (Likud) and Rabin (Labour), is no exception. Israel's credit is running out in Washington, the Arabs are offering peace, the world is newly ordered. Surely Decision is nigh?

Probably not. The safest bet for next week's vote is that, like the previous election and the one before that, it will fail to produce a clear win. Some polls have been putting Mr Rabin a smidgen ahead of Mr Shamir. The Labour leader may well become Israel's next prime minister (see page 41). But pollsters do not rule out the possibility that he will lose, or be obliged to take Labour into yet another stifling coalition with Likud. Besides, not even an outright win for Labour amounts to the same thing as a Decision on the West Bank; still less the decision to withdraw that the rest of the world wants.

Israel's inability to make up its mind infuriates a world grown weary of the Middle East, and impatient to see the Palestinians emerge into independence. The blame for Israeli inertia is pinned variously on weak government (produced by a masochistic version of proportional representation), on religious fanaticism, on fear of the Arabs. All these things, and more, are part of the problem. But the chief cause is something more mundane: the ordinary human habit of putting off until tomorrow decisions that are too painful to take today.

Immediately after 1967 the decision to give up territory

would not have hurt so much. Back then, though, the Arabs would not talk. Now that they are talking, Israel has had a generation to swallow up the West Bank, creating not only facts on the ground—all those Jewish settlements—but psychological facts as well. Young Israelis never knew, and older ones scarcely remember, the long-ago borders to which the Arabs want Israel to return. No party advocating instant withdrawal could win an election. Withdrawal to which borders? With what guarantees? And what about Jerusalem? Until those questions are answered, most Israelis want to keep their options open.

Keeping options open is, therefore, exactly what both main parties offer. The Likud, it is true, stands for Greater Israel, Labour for territorial compromise. But these are general proclivities, not policies for today. The Likud does not advocate annexing the West Bank; Labour does not advocate a Palestinian state. Both parties promise to stay in the American-sponsored peace talks that started in Madrid eight months ago. They both endorse America's two-step plan for phasing peace in: first an agreement on Palestinian self-government, then, five years later, a decision on whom the land belongs to. In other words, Labour and Likud could in principle stagger along in a coalition until 1997 before they reached the fork in the road.

Pray for Labour, prepare for Likud

So next week's vote does not matter? It does. Although he is no cooing dove, Mr Rabin would be a gentler peace partner than Mr Shamir. He would stop the settlement blitz, offer a more generous version of Palestinian self-government and probably talk America into renewing the friendship (and the loan guarantees) it withdrew from Israel when Mr Shamir was in charge. The Labour Party represents a pragmatic strain in Zionism, readier than Likud to recognise the limits of Israeli power and the need to accommodate Palestinian aspirations. Mr Rabin's vision of peace is still very different from that of the Palestinians: he foresees a partial withdrawal from the West Bank, rules out a fully independent Palestine and insists that Jerusalem remains unified under Israel. But he embraces the core principle—land for peace—that Mr Shamir rejects.

Mr Rabin would, in short, be a welcome winner. Yet it does not follow that a Likud victory would be so dreadful that it destroyed the peace talks. Indeed, the reason Israel's election is taking place next week is that Mr Shamir's government collapsed when he refused to let his righter-wing coalition partners stop him from tabling proposals for Palestinian self-government. Mr Shamir is realistic enough to understand that world opinion is strongly against everlasting Israeli occupation. The same pressures that thrust him into the talks in the first place—the domestic appetite for peace, American armtwisting—can still keep him talking after the election.

Talking, though, is not an end in itself. The Palestinians say that Israel has not yet offered them anything serious. They are right: its self-government proposals fall well short of those a previous Likud government put its signature to at Camp David more than a dozen years ago. But the Palestinians' demands—in effect, instant Israeli withdrawal and instant Palestinian statehood—have been as excessive as the Israeli offer is miserly.

Can the gap be closed? Since Madrid, the Americans have looked on while the two sides have cracked their heads together. Once Israel's electoral distraction is over, it will be necessary for the Americans, despite electoral distractions of their own, to propose an impasse-breaking compromise. The old Camp David agreement, which was never implemented, is still a fair model: Israel's soldiers withdraw to specified security zones, its military administration winds itself up, Palestinians elect a self-governing authority and run their own affairs for five years, pending a final settlement.

To impose such a deal, however, the Americans have to stop the settlement drive. Unless that happens, the Arabs will leave the negotiating table. In pursuit of a settlement freeze, George Bush has already withheld $10 billion of loan guarantees from Israel. If Likud wins, he may have to turn the screw tighter still. That is why, although the peace hope can be made to survive a Labour defeat, a victory will make life so much easier—not just for Palestinians, but for Israelis as well.

America's vigilante values

Freedom of action under the law can sometimes go too far

IN SOME ways America is the most legalistic of nations. Unlike almost every other country, it was founded on laws. It swarms with litigants, lawyers and judges, and the tentacles of the law reach into every crevice of national life. Yet America's regard for law does not always translate into law-abiding behaviour; in fact, it may encourage the reverse.

Out of reverence for the constitution, America has always refused to countenance effective national controls on the possession of guns: a restraint on personal liberty that seems, in most civilised countries, essential to the happiness of others. On the world stage, too, America has shown this week that where the constitution allows actions unthinkable under international law, it will go with the constitution. What is at issue, in American eyes, is the freedom to defend one's own interests under the law. In both cases, America ends up as a sponsor of vigilante values, less than worthy of the moral weight it has always wished to carry in the world.

According to the government, there are now 66.6m handguns in circulation in the United States (see page 26). Most of these are kept, according to their owners, to protect themselves against random crime. Fatalities from these are now the second-highest cause of death among high-school children, half of whom say they can get guns easily. Shocking as these figures are, they still do not cause Americans to call for tighter controls. Even the doctors who swab the wounds say merely that the figures should be treated as a "public-health crisis". The comparison they draw is with road deaths, caused by consumer durables that everyone should still be free to buy, own and enjoy.

Although certain states have made it harder to buy and carry guns, the constitutional principle is hardly disputed. Since the Los Angeles riots six weeks ago, sales of handguns have rocketed. The psychology behind the surge is that guns are

needed to defend people and property when the police cannot. It is a return, in short, to vigilantism; citizens must be free to act to protect their own interests, whatever the costs of promoting a new cycle of violence. The law itself condones behaviour that will lead, in the end, to more lawlessness.

A constitution for kidnappers

The world might shrug at this intractable American problem, and turn away. But these vigilante values also surface on the international stage, where they are harder to ignore. On June 15th the Supreme Court ruled that the United States may kidnap a criminal suspect from a foreign country (in this case, Mexico) and put him on trial: even if the suspect is a foreign national, even if the country objects, and even if proper extradition procedures already exist in treaties. International law might be violated by it, the chief justice admitted, but the American constitution was not.

America's unease with international laws and treaties has a long history. As at the Rio summit, the United States often prefers not to sign treaties pellmell, giving the excuse that it takes laws too seriously. True, in part; yet the other part, seen in 1984 when America mined Nicaragua's harbours in defiance of international law, is that America will not tolerate curbs on its freedom to defend what it sees as its national interests. America will do what America must, violent or not. It has long flirted with the idea of assassinating some nasty foreign leaders, and has long envied Israel its capacity for bold unilateral action to rescue hostages. Now it has given legal blessing to the idea of going in and seizing people it wishes to prosecute.

Mexico, a country whose legal system Americans often deride as primitive, says that a "pall" has been cast over its relations with the United States. Other countries may feel the same way. America sets itself public standards that often seem moralistic to the point of self-righteousness, and it remains serious about them; American values, it believes, are worth promoting abroad. Chief among those values is the one of law-based freedom. Yet in its attitude to guns at home and abduction abroad, America gives a bad name to freedom of action under the law. It need not wonder why its reputation in some quarters as a free-firing bully has proved so difficult to lose.

The sports page

Starting with this issue, we will write every week about sport

THE Romans favoured *mens sana in corpore sano*, but for many centuries after that the cleverer minds tended to think of sport as a sweaty, infra-dig affair. No longer. Today sport is the escape from presidential cares as much as the ladder out of the ghetto; it is part of the international vocabulary; it is very big business. Like it or loathe it, you cannot ignore it.

In recognition of this, *The Economist* is introducing a sports page. This move is not as dramatic, or as belated, as it may seem. We have always written about sport now and again. In the past year we have carried articles on, for example, the Indianapolis 500 as a celebration of America's industrial midwest, on the sale of England's Paul Gascoigne to an Italian soccer club, on the old Soviet Union as a chess superpower and on Albertville's unsuitability for the winter Olympics. But sporadic coverage is no longer appropriate. Sport is much more than a sideshow, a mere pastime.

Television has made most of the difference. The tens of millions viewing the European nations' soccer championship in Sweden this week, and the hundreds of millions viewing the summer Olympics in Spain next month, will each have a better seat and see more than nearly all the spectators at the actual events. A golf tournament at Pebble Beach, California, a middleweight boxing bout in Bloemfontein, South Africa, or a test match from Melbourne is now only a button-push away.

As a result of television, once-minor sports attract a large following almost overnight: snooker in Britain; gymnastics and ice skating in the United States. Sports with a national appeal balloon into international sports. Basketball is fast catching on in Italy, Spain and other parts of Europe. On the Sunday of the Super Bowl, new fans of American football, in 60 countries from Thailand to Iceland, tune into what has become a global event. In America itself, crime slumps, streets empty and families huddle around the television in the den.

Sport also draws public attention to some big moral questions, more powerfully than any number of speeches by politicians or sermons by clerics could do. Magic Johnson getting AIDS frightened more American youngsters into seeing the deadly dangers of sexual promiscuity than anything that had happened before. The use of steroids to boost athletic performance has raised broader questions about unfair competition and what responsibility society has to protect people from themselves. The pros and cons of imposing limits on technology are highlighted by the different considerations between such limits for, say, motor racing and boxing. Souped-up racing cars help to produce better runabouts for everybody; deaths in the ring would be routine if anybody were daft enough to lift controls on the size and shape of boxing gloves.

Money and fun, but above all fun

Such questions underline the extreme competitiveness of professional sports. Throw in the serious money and it is apparent why so many professional players do not seem to be enjoying themselves. In their early 20s, tennis brats look ten years older. Muhammad Ali, his brain scrambled by too many blows to the head, shambled around Britain like a zombie on a book-signing tour this month. Every one of the 1,200 players in America's National Football League is likely to be injured during a four-month season. Many will be hurt more than once.

Without being po-faced about it, our sports page will sometimes write about injuries, drugs and other hard questions in sport. But it will be chiefly a celebration, a recognition that sport is, above all, supposed to be fun, at least for spectators and amateur participants. Sport can provoke just as passionate arguments as politics or religion, but it is not so serious that friends need ever fall out over it.

Ride the wave

The rich world's ageing population will affect international competitiveness as well as the structure of financial markets. It need not mean the end of growth

DEMOGRAPHY has been kind to the rich world just recently. The baby boom that ran from peace in 1945 to the pill in the early 1960s created a big cohort of workers now in their prime. Roughly half of all workers are already in that phase of life—age 35 to 55—when they save most in order to buy homes, educate their children and, above all, anticipate old age. With plentiful labour and plentiful savings, economies can hardly fail to grow. And with relatively few old people, the burden of social-security taxes has been relatively light.

This bonanza will soon run out. Early next century the boom generation starts retiring. Each worker will have to support more elderly dependants. He will therefore be poorer, unless higher productivity permits wages to rise. Savings rates will fall, as retired baby-boomers consume their nest eggs. Fewer workers, less abundant capital: growth may no longer be taken for granted. Indeed, demography may depress growth just as growth is most needed, to meet the rising cost of pensions and health. Higher taxes to pay for grandparents may dampen incentives, so making the baby bust worse.

This pattern will affect just about all the rich economies, but at different times and with varying force. It will therefore shake up international competitiveness. Some countries are especially vulnerable, for they have no savings set aside in pension funds. Those that do have funds are protected, but not as completely as they hope.

Troubled Japan, then troubled Europe

As the Japanese have grown rich, they have become healthier and less fertile. Their life expectancy overtook that of Americans in 1982; it lengthens still. The result of this marvellous achievement is a marvellous crunch.

In 1990 11% of Japan's population was aged 65 and over, making it younger than America or Western Europe. By 2010 18% will be 65-plus, making Japan the greyest part of the rich world. Japan's diminishing workforce faces rising taxes to pay for multiplying grandparents. Recently Akio Morita, the chairman of Sony, has made much of the light social burdens on Japan's economy. They grow weightier all the time.

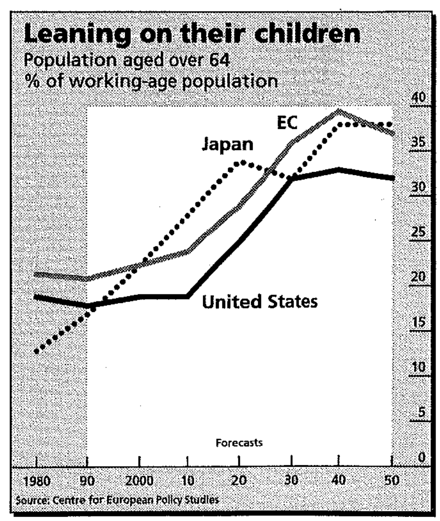
A 1986 IMF study reckoned that Japan's social-security costs, at 15% of GNP, were the lowest of the OECD's seven largest economies. By 2010, however, the study expected Japan's costs to have risen to 26% of GNP, around the middle of the pack. Japanese firms do not have long-established pension funds, so meeting these costs will cut into profits and wages all the more. Already pension contributions add $87 to the cost of each Honda car.

In America, by contrast, roaring markets have left many pension funds with more than enough money to meet their future liabilities. As a result, firms have taken "contribution holidays"; pensions add nothing to the cost of an American-built Ford or GM car. Meanwhile Japan's dramatic ageing hurts competitiveness in another way as well. In the past, the country's system of pay by rank, and rank by years of service, kept down labour costs because the workforce was young. Now it has the opposite effect.

After Japan the pension crunch will hit Europe, between 2020 and 2040. The OECD expects the EC's population (minus eastern Germany) to peak in 2000, at around 330m. Thereafter it may fall to 290m by 2050. Some reckon the decline will be steeper, because the OECD assumes that EC fertility will rise to the replacement rate of 2.1 children per woman of child-bearing age. In 1990 it stood at 1.57.

Worse, the EC (with the exception of Britain and Holland, which have large private-sector pension funds) has put aside even less than Japan for tomorrow's grandparents. A higher proportion of the cost of retirement—pensions and health—is paid for through public schemes than in Japan or America. In 1985 social-security pensions as a percentage of GDP came to 11.8% in continental Europe, compared with 7.2% in America, 6.7% in Britain and 5.3% in Japan.

France, Italy and Spain currently pay pensions to the old directly out of money earned by the young. Ageing will make this unsustainable. A French government paper



recently predicted that, if the value of pensions remains unchanged, contributions will leap from the current 19% of payroll to between 31% and 42% by 2040—much worse than anything predicted for Japan. Italy is still more vulnerable. It spends nearly 14% of GDP on pensions now, up from 5% in 1960. With a budget deficit at 10.5% of GDP, its pensions are already unaffordable.

Shrinking funds

Rich economies that do have well-established pension funds—America, Britain, Canada, Holland—may be tempted to feel smug. Yet they too are vulnerable. Capital will become scarcer, and—unless demand for it drops—more expensive to raise.

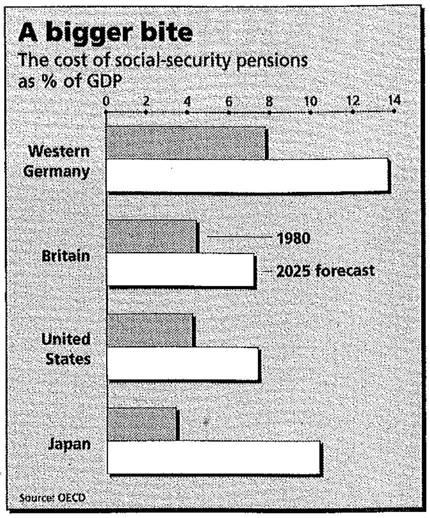
The median baby-boomer is now in his mid-30s; he will carry on saving hard for the next two decades. As a result, private-sector pension funds will grow rapidly. According to Michael Howell and Angela Cozzini of Baring Securities, each percentage-point rise in the share of the population over 45 years old results in a roughly equivalent rise in the ratio of institutional savings to GDP. In 1990 pension funds in Japan, the EC and North America amounted to $4.2 trillion. By 2000 they are expected to swell to as much as $11 trillion. Japan's funds are growing especially quickly; many were founded recently, and require large contributions to catch up with their liabilities.

These burgeoning funds plough their expanding riches into stockmarkets, pushing up share prices, making equity finance cheaper to firms. At the same time, the funds have contributed to dramatic financial innovation. That makes equity more convenient and, again, cheaper for firms.

It is no coincidence that this new sophistication is concentrated where there are funded pensions. Rich economies without funds—Germany, Italy—have primitive stockmarkets, never mind designer derivatives. Big German and Italian firms have got round this problem by raising money in New York or London. For smaller ones, the cost of equity finance has been higher than it might otherwise have been.

The funded economies will soon lose this advantage. For one thing, others will catch up, as states' inability to sustain unfunded pensions compels the private sector to do more. Mr Howell thinks the shift will transform Europe's smaller stockmarkets. Italy's market capitalisation-to-GDP ratio could rise by as much as 1,000% over the 1990s, Germany's by more than 300%. That compares with a projected 17% rise for Britain's established stockmarket.

More seriously, the funded economies will see their funds shrink, as ageing workers retire and spend their booty. When pension funds stop growing, some of the bounce and innovation in financial markets may fade. If the demand for capital remains the same or grows, duller equity



prices—or, to put it the other way round, higher equity yields—will push bond yields higher, and returns on cash. Interest rates, which are already high in real terms in many countries, will rise. And demand for capital might well grow, for companies' first response to a shrinking workforce is often to replace labour with capital.

Call up the reserves

The greying of the baby-boomers and the potential pressure on capital costs present special problems for Germany and Japan, too. Tax rules in both countries have encouraged firms to promise pensions without creating special funds to pay for them. Instead, firms save for their employees' retirement by making reserves. German firms can deduct their contributions from taxable profit; Japanese firms can write off part of them.

Reserves have one great attraction for companies: the employers themselves can decide how to use them. German and Japanese firms have invested pension savings in ways that further their business aims, rather than entrusting them to an investment manager who merely tries to earn a good return on them. One frequent use is to buy stakes in friendly companies, so both Germany and Japan are dominated by families of firms that hold stakes in one another. This web of cross-shareholdings shields firms from hostile takeover. It has bred strong relationships between producers and suppliers. Outsiders complain that these family economies are hard to break into. That will change with demography. As retired workers multiply and active workforces shrink, firms will run down their pension reserves and find it harder to hang on to their friendly shareholdings.

Even before the baby-boomers retire, demography will punish Germany for its pension habits. Accounting rules there permit firms to set aside a smaller share of each worker's wages than do their British rivals, until the worker reaches 55. For the ensuing decade, Germans have to contribute more: for a 64-year-old, Germans set aside 34% of pay compared with 26% in Britain, according to Hubert Peters of Coopers & Lybrand, an accounting firm. This will prove expensive as the workforce ages.

Beyond retirement, German firms are required by law to raise pensions in line with inflation. This liability is unaccounted for in their reserves. (Funded schemes, by contrast, set contribution rates high enough to cover inflation-proofing promises.) As German unification pushes up inflation, indexation is getting dearer.

Crunch medicine

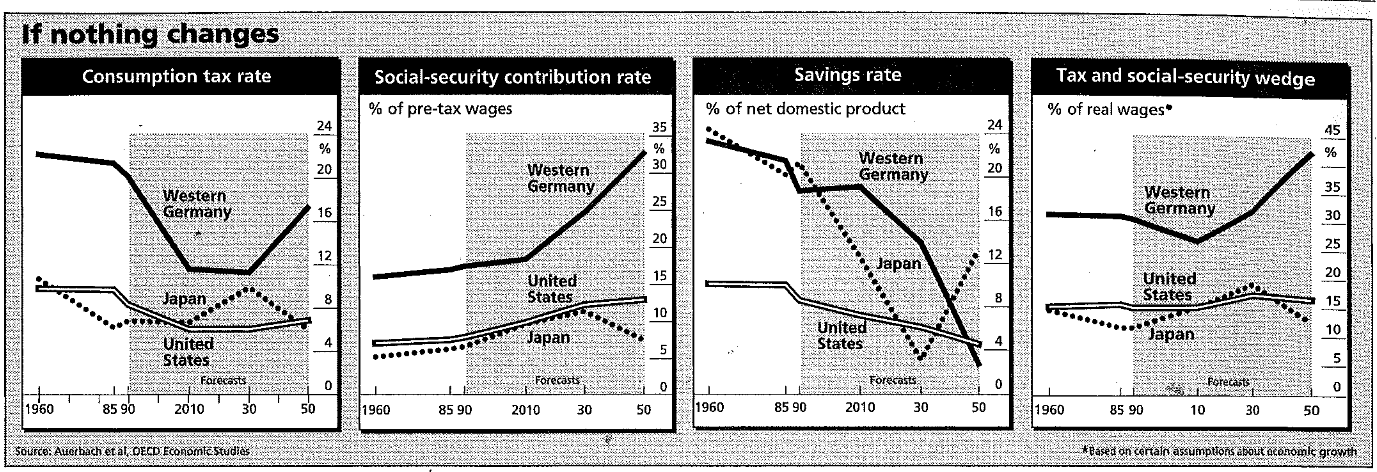
For countries with unfunded pensions, population trends suggest a fiscal crisis. Others may face costlier capital and slower growth. Yet the history of extrapolation should temper the conclusion that calamity cannot be escaped. Malthus predicted demographic disaster: he feared too many people, not too few. In 1971 the Club of Rome warned that the world risked exhausting its resources: in real terms, commodity prices have declined steadily since.

The rich world may adapt remarkably well to the shock of falling numbers. Dwindling workforces and savings rates may turn out to stimulate innovation—the invention, refinement and application of technologies and business techniques. This is an uncertain area of economics; but most studies suggest that advances in knowledge account for just over half of total growth.

Equally, workers face higher taxes to pay for grandparents. But it does not inevitably follow that they will be worse off. The supply of labour is likely to contract more than the supply of capital: this increase in labour's relative scarcity should raise its price. Higher social-security taxes may also be offset by lower consumption taxes per worker, since the consumption base will expand with the growing ranks of old. One econometric study* suggests that, in the period from 1985 to 2050, the wedge that tax and social-security contributions drive between pre-tax and after-tax wages will expand and then shrink in Japan and America, while widening in Germany (see chart on next page). If governments adopt policies to ease the shock of ageing, including later retirement, workers may actually find themselves better off in all three countries.

The need for government action presses most in continental Europe, because of the absence of funded pensions. Fortunately, Europe has plenty of scope to spread the burden of grandparents by putting more people to work. In 1990 just 60% of the EC's people in the 15-64 age band had jobs, according to Jorgen Mortensen of the Centre for European Policy Studies in Brussels;

*"The Economic Dynamics of an Ageing Population". Alan Auerbach, Laurence Kotlikoff, Robert Hagemann, Giuseppe Nicoletti. National Bureau of Economic Research, No 1268. Reprinted from OECD Economic Studies



that compared with 71% in America and 73% in Japan. If Europe increased its employment ratio by ten percentage points, it would cancel out the 20m drop in its workforce due to demography. This is not an impossible target. Over the past three decades, America has achieved that sort of rise.

Europe's low employment ratio reflects the large numbers of people who cannot find work and of women who choose not to work. As demography takes its toll on the labour supply, unemployment may come down—provided that the unemployed have the education and skills that firms are looking for. A drop in EC unemployment from, say, 9% to 6% would mean 6m extra people in jobs and contributing towards the health care and pensions required by the elderly.

Europe would still need to find another 14m workers to defeat demography. Young immigrants could help, but are sadly unpopular. Around 6m new workers could be recruited by raising female participation rates from the current roughly 50% to America's 60% (not to speak of Japan's 70%). Governments could encourage this, if it is possible to do so without discouraging childbearing. The growing demands of the elderly will make it hard to find extra cash for creches, for example. And if grannies' needs push up taxes, women may grow less, not more, inclined to work.

Next, something could be gained from raising the retirement age. Here the scope for absorbing the demographic crunch is not confined to Europe. America's government has made mandatory retirement and discrimination on the basis of age illegal. Japanese firms are pushing the retirement age up from 55 to 60.

In Britain many firms, ordered by the European Court to equalise retirement ages for men and women, have seized the opportunity to equalise upwards: women will no longer collect a full pension at 60. Germany raised its retirement age to 65 in 1989. Denmark commendably makes both men and women struggle on to 67. Italy is the laggard. It has not got around to implementing plans to raise the retirement age to 65—up from 60 for men and 55 for women.

The other way to ease the crunch is to encourage saving. This is best done with a mixture of tax breaks and loud warnings that the state cannot be relied upon to provide for old age. Here, again, America and Japan show continental Europe the way forward.

Towards funding

In 1980 Japan reduced tax breaks for reserves that companies made to pay for pensions; this encouraged them to fund pensions. By 1988 the proportion of Japanese workers in private funded plans had risen from 31% to 38%. Japan's pension assets will grow by 16% a year in the near future, reckons Asset Strategy Consulting, a Californian firm. The more Japan keeps saving, the more easily it will absorb the cost of ageing. In parts of Europe this lesson has been learnt. Spain, Portugal and Belgium recently cancelled tax breaks for pension reserves. Germany has yet to do so.

In 1983 America's federal government laid down that, between 2000 and 2022, social security would pay out a smaller percentage of pre-retirement earnings. In theory this should goad Americans to participate more enthusiastically in private pension schemes. Not all the evidence so far is encouraging. The percentage of American workers in company pension plans has fallen from its peak of 49% in 1979 to 43% last year. That reflects declining unionisation and lower wages among less skilled workers. Big, union-dominated firms seem unlikely to regain their old share of the economy, so traditional occupational pensions may not recover either.

More flexible schemes, not based on the assumption of a lifelong career with one employer, may fill the gap. Tax-privileged company savings plans, which do not promise a fixed proportion of salary on retirement, are gaining ground in both America and Britain. So are personal pensions. In America the number of individual retirement accounts has shot up by more than 3m since 1981, when Congress opened them to workers who were also participating in company plans. Since 1988 over 4.5m Britons have started personal pensions. Similar schemes have been started recently in France and Switzerland.

To make the most of the new savings, governments must allow them to be invested freely. American and British pension schemes are already free to chase the best mixture of risk and return; other countries are slowly easing curbs on "risky" investments like equities and foreign securites.

Once freed, money may well flow disproportionately to developing economies. For this is the surest way to beat demography. The old world will buy a stake in the productive energies of the young one, so supplementing its income from the diminished cadre of young workers at home. This has happened before. Between 1890 and 1911 the French labour force was relatively static. Half of French savings went abroad, but only a quarter of British and a tenth of German savings. The current fashion among first-world money managers for investing in third-world markets is usually seen as reward for the developing countries' economic liberalisation. It also reflects the rich world's needs.

Tomorrow's providers

An uncertain world

WASHINGTON, DC

IN THE foyer of the Air and Space Museum in Washington, which Boris Yeltsin, the president of Russia, visited on June 16th, an American Pershing-II missile and a Russian SS-20 stand side by side. They are symbols of a period of terror. Yet they represent, too, a period in which America knew precisely what it thought of its principal rival; knew how to shade its foreign policy in response to that rival's interests; and knew what the point of a summit between the head of Soviet Union and the president of America was. Those certainties are long gone.

In 1987 and 1990, when Mikhail Gorbachev visited Washington, the whole city was electrified by his presence. This time, as Mr Yeltsin tramped the familiar trail—two days in Washington, a visit to Annapolis, a trip to Wichita, Kansas, to feel the beat of the heartland—his presence was hardly noticed.

The end of the cold war, the collapse of communism and the Soviet Union, the appearance in Washington of the leader of Russia not as a rival or equal but as a supplicant—these changes have left American foreign policy-makers tacking in a fog without a compass. In the week before Mr Yeltsin's visit, George Bush was twice vividly reminded of the ways in which a world no longer gripped by a manichean struggle between polar opposites is a world in which America's president is unable to control his own destiny.

In Panama, the site of the first piece of post-cold-war adventurism (an invasion in 1989 unmotivated by any intent to annoy the Soviet Union), Mr Bush expected to be welcomed as a liberator. Instead, he found himself dabbing his eyes as tear-gas wafted towards him.

From Panama Mr Bush went to Rio for the closing days of the Earth summit, where the stakes were much higher, and the loss of certainty in American foreign policy that much more obvious. Rio was the perfect post-cold-war event. The summit was on a subject that did not lend itself to the ideological certainties of the past, and its agenda was at least partly set not by governments at all, but by private corporations and pressure groups. Compared with the old well-ordered pattern of summits, Rio was anarchic. And in this anarchy, America lost face. When Mr Bush got there, he gave a blustery speech on how vital an environmental "leader" America was. Real leaders do not do have to remind their audience of the fact.

Americans seized on Mr Yeltsin's visit to try to recreate some stability in their world. The key word during the summit was "partnership". But how to divine the content of this partnership? The centrepiece of the summit turned out to be superpower relations of the old kind; an agreement (see box on next page) to cut strategic nuclear weapons to 3,000-3,500 for each side by 2003, or by 2000 if the Americans are able to help the Russians pay for the decommissioning costs.

Mr Yeltsin also brought the dramatic news that some American prisoners of war may have been taken to Russia during the conflicts of the past 50 years; he promised to open all relevant archives to get to the bottom of the mystery. These two gestures of goodwill, and his forceful speech to Congress on June 17th, did much more to make the case for an aid package from America to Russia, now stalled in Congress, than Mr Bush has ever done.

In private sessions, Mr Bush and Mr Yeltsin touched on what they could do together to enhance regional security, in, for example, the Balkans, the Transcaucasian republics, and the Middle East. As Steven Sestanovich, of the Centre for Strategic and International Studies, points out, Russia has already been helpful to America. Against the background of some controversy at home, Mr Yeltsin supported American demands in the United Nations Security Council for sanctions against Serbia.

Indeed, Mr Sestanovich argues that, if one takes the optimistic view, what may be in the making is a "new special relationship". In other words, America might conclude (just as it once did with Britain) that past grandeur admits a now diminished power into membership of a rather exclusive club. And Russia might conclude (as Britain did) that being a friend of America is one way of preserving the clout that it can no longer muster on its own.

Some sense of this was on view during the summit. Plainly, the Russian government wants the Americans to act as honest brokers between itself and the IMF, whose own aid package to Russia is making slow progress. American officials have some sympathy with Russia's claim that its case, in terms of the size of economic restructuring necessary and the length of time that the economy was under communist domination, is one that requires special consideration.

For those who dream of a new partnership, American help for Russia can be justi-

Trust Yeltsin, watch the dogs

Who cuts what

THE START treaty between the United States and the Soviet Union has not yet been ratified, but the deal that was hammered out during the years of hard negotiating began crumbling late last year as both sides announced unilateral cuts. The new Yeltsin-Bush agreement would lower the totals much further, to around half of what START would have allowed.

The agreement gets rid of all land-based missiles with multiple warheads (ICBMs). This represents a substantial concession by Mr Yeltsin, as Russia has most of its weapons in such missiles (see table), whereas the United States is much more dependent on submarine-based missiles (SLBMs). The second new feature, also a Russian concession, is that it agreed to scrap all its SS-18 heavy missiles. The fact that it was allowed to keep these missiles when the United States had none was a controversial provision of START.

The centrepiece of the new agreement is the limit of 3,000-3,500 warheads. No more than 1,750 of these can be deployed at sea. This new limit will require deep reductions by both sides. The United States will have to halve its submarine-based warheads, either by reducing the number of warheads per missile, cutting the number of missiles or by getting rid of some submarines. The best guess is that it will cut the warheads.

Down they go

Warheads on	Pre-START forces US	Pre-START forces USSR	START limits	National Bush-Yeltsin forces US	National Bush-Yeltsin forces Russia
ICBMs	2,450	6612	4,900	500	500
SLBMs	5,760	2804		1,728	1,744
Bombers	2,353*	855*		1,264	800
Total	10,563	10,271	6000*	3,492	3,044

* Because weapons on bombers are counted by a formula instead of actual numbers, the true totals would have been much higher than the figures shown here

Sources: START treaty; Arms Control Association

fied in the long term, and not just by the size of a future free Russian economy. The world's likeliest flash-points in the future may well be on Russia's borders; on its lightly populated border with China, and on its southern borders with Islam. The theory goes that, as the world's top military power—one that always faces the risk of being asked to intervene in regional conflicts—America has an interest in maintaining a strong and democratic Russia able to secure peace on its borders.

Needless to say, none of this is new. De Tocqueville, 150 years ago, predicted a world in which relations between America and Russia were the axis about which everything else would revolve. Today in Washington, a striking number of people are prepared to say that such a vision can be true not just when the two countries are adversaries but when they are allies, too.

The sinews of this new partnership, however, are still largely imaginary. Last year there were 177,000 college students in America from Taiwan, China, Japan, India and Singapore, compared with just 1,200 Russians. If there is to be a new partnership between what were once polar opposites, it will need to be founded on a host of low-level, personal contacts as well as on the high theory of international relations. Given the muted American reaction to Mr Yeltsin's visit, it is far from certain that enough Americans are interested in such contacts.

Aid to Russia

Sometime

WASHINGTON, DC

"ENTREPRENEURS," announced the host of the party thrown for Russians of that description, "like artists and writers, are the free-thinkers of society." Few of the Americans present bothered to stop chattering to each other to listen. The chairman of Aeroflot, an honorary entrepreneur for the occasion, muttered sourly that American businessmen "won't risk even one dollar" in Russia. The trouble was, "Russians don't have even that much."

Boris Yeltsin and his team did indeed spend much of their time in Washington trying to get money and goodwill from commerce and Congress. This often seemed a thankless task. True, much was made of a new Russo-American business agency. True, too, a new tax treaty was signed. And George Bush offered Russia most-favoured-nation trading status. But Russia has also learnt about some of America's less edifying trading ways. The United States has slapped "dumping" duties of over 100% on one of the few products Russia can usefully export: uranium, the former Soviet Union's third-largest export. "You are a God-fearing woman," Mr Yeltsin told the commerce secretary. "How can you charge such rates?"

Mr Yeltsin himself has recently done much to entice foreign business to Russia, and American companies are looking round by the hundred. On June 15th Mr Yeltsin signed two decrees that played to an international audience. The first made provisions for Russian companies to go bankrupt. That should allow Russia's most rotten companies to be shut down or sold (including to foreigners) if they cannot pay their debts. The second decree gave private companies the right to own their land. Foreigners may now also repatriate dividends. In short, Russian business law is starting to look like that in other third-world economies.

American investments in Russia are primarily by big brand-names. The original Moscow McDonald's (having solved its problems with potatoes) is as popular as ever, serving 30,000-40,000 Russians a day, even though the price of a Big Mac has risen to 69 roubles from 4 roubles two years ago. Pepsico now has 40 bottling plants throughout the old Soviet Union and sells over 1 billion bottles a year. Last year, Polaroid sold

'AT LAST—THE CAVALRY!'

25,000 Moscow-made cameras.

Elsewhere, the story is less successful. Take Russia's limping oil and gas industry, whose recovery is critical to the whole economy. There have been only two American ventures in this sector, neither of them sucesses. Talks involving deals for big western oil companies, notably Chevron, have been bogged down by spats about payouts and foreign control.

Of more immediate help to Russia than foreign companies would be the enactment of Mr Bush's Freedom Support Act, the main vehicle for Russian aid that now languishes in Congress. Few congressmen, however, are prepared to admit that this bill takes precedence over money for pressing domestic needs.

The bill's core is a $12 billion increase in America's contribution, long-delayed, to the International Monetary Fund. The Fund says it cannot do without the money beyond the end of the year. The $24 billion in western aid promised early last April to Russia relies upon this bill going through, but it has fallen foul of domestic politics. At first, Congress welcomed the idea of helping Russia and the rest of the former Soviet republics. Then came the riots in Los Angeles, which persuaded Congress to propose legislation to help the cities.

The $2 billion put forward by the Senate, four times larger than Mr Bush's request, drew the threat of veto. (The administration has also been critical of Congress's desire to extend certain unemployment benefits.) Democratic leaders in Congress, damned if they were going to let Mr Bush have his way on Russian aid, have delayed the bill. Nor has Mr Bush been helped by his own party in Congress; few Republicans have openly stuck up for him.

The bill looked even more doomed after two senators, John McCain and Bob Smith, suddenly got it into their heads to make aid conditional upon hard information about prisoners of war who may have been sent to Russia. The rapturous reception given to Mr Yeltsin's congressional address is now probably enough to tilt the balance in favour of the aid bill being signed this summer. As for Mr McCain (a former prisoner of war himself), he professed himself disarmed by a chat with Mr Yeltsin.

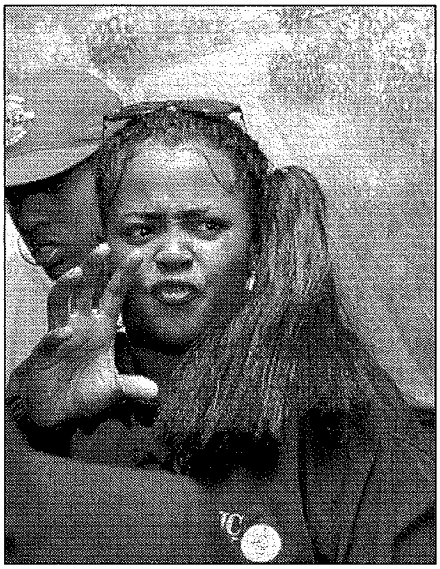
That still leaves Russia's dispute with the International Monetary Fund about the conditions required for aid money (notably a $6 billion rouble-stabilisation fund) to be disbursed. The deadline originally set for an IMF deal, July's Munich summit, now looks optimistic. As Jeffrey Sachs, a Harvard professor and Russian adviser, put it to a conference of the Bretton Woods Committee on June 15th, there is "a crisis of spirit in the negotiations." So long as that crisis persists, American businessmen will keep chattering amongst themselves.

The campaign

Rockers and rappers

LOS ANGELES AND WASHINGTON, DC

THE presidential campaign, like all others before it, continues to throw up the unexpected. Voters were once meant to be bored and frustrated with politicians; but in appearance after appearance on TV call-in shows (whose hosts have stolen the election from under the noses of the heavyweight pundits), the presidential candidates are consistently winning higher-than-average ratings. How can this be?



Souljahring on

Forget the argument that the candidates are going on such shows because they expect easy questions. Ross Perot, the independent candidate for the White House, was more discomfited by a caller from Florida asking him about his plans for curbing Social Security (he thinks people should volunteer to give up their benefits) than he has been by any big-foot pundit. Still, the polls, for what they are worth, continue to show Mr Perot leading both George Bush and Bill Clinton.

Mr Clinton himself was expertly grilled by a "representative" audience in the studios of MTV, a rock-music cable channel, on June 16th. He spent nearly three hours there, and his patience may pay off. Each week about 15m people under 25 watch MTV, which has been covering the presidential campaign with panache and spiffy camera-angles since the New Hampshire primary.

MTV has been supporting Rock the Vote, a voter-registration drive among young people, which claims to have gathered in 100,000 new voters in the past year, and which says that 78% of those it registers actually vote in elections. In general, the number of young people voting in presidential elections has steadily declined. In 1972 49.6% of those aged 18-24 voted; in 1988 just 36.2% did. With both Mr Perot and Mr Bush old enough to be young voters' grandfathers, Mr Clinton has an opportunity to appeal to them; but his charisma is not on a par with either John or Bobby Kennedy's, saxophone notwithstanding.

Mr Clinton collided with the youth culture again on June 13th, at a convention of Jesse Jackson's Rainbow Coalition. He criticised Sister Souljah, a rap singer, who had been on one of the convention's panels the day before. Ms Souljah's month of fame

Shalom, LA

LOS ANGELES

MIGHT a United Nations peace treaty which failed in the Middle East over 40 years ago work for the gangs of South Los Angeles? Bloods and Crips are studying a document closely modelled on the 1949 Egyptian-Israeli General Armistice Agreement. In the updated version, "Palestine" becomes "Watts, California" and "armed forces" is changed to "armed gangs". Where the original treaty banned "land, sea or air forces from committing warlike acts", the updated version outlaws "drive-by shootings and random slayings".

Thanks to an oral truce, there were only two gang killings in South Los Angeles last month, compared with 16 in May last year. Indeed, most of the violence at "unity barbecues" has been directed against the police, although there is no sign of an organised campaign. The new treaty tries to set a more formal peace. It is the brainchild of Anthony Perry, an ex-gang member who found the old 1949 treaty in a library and translated its ten pages into gang language.

Mr Perry told the *Los Angeles Times* that the treaty was appropriate because "in both cases you have two peoples who are basically related, but divided." The new armistice comes with a new wide-ranging "United Black Community Code" for gang members, which urges them to go to school and prohibits them from sporting their "gang rags" more than three inches out of their back pockets in a rival gang's territory.

The 1949 armistice did not last, and led to a series of wars between Israel and Egypt. But it's the thought that counts.

started when, after the Los Angeles riots, she gave an interview with the *Washington Post* in which she seemed to suggest that blacks should take a week off from killing other black people and kill whites instead. Mr Jackson, incandescent with rage, accused Mr Clinton (with whom he has had run-ins for years) of trying to use the rap singer's remarks as an opportunity to appeal to white Americans by criticising a black. Ronald Walters, a professor at Howard University, argued that Ms Souljah was a representative voice, and asserted that the incident would simply make the black electorate more cynical about Mr Clinton.

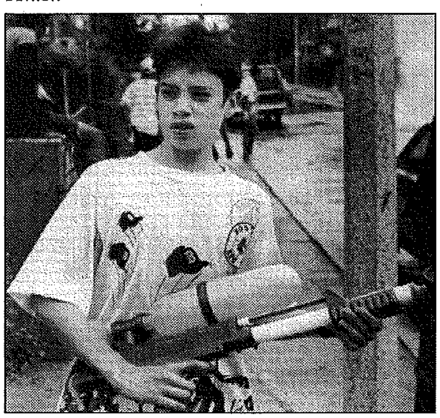
At the heart of the matter is a debate in the Clinton camp on whether it is better to concentrate on the "core" Democratic constituency, in which blacks play a large part, or to reach out to the so-called Reagan Democrats, the blue-collar workers who voted Republican between 1980 and 1988. In what may be a three-way race, Mr Jackson argues that the first course makes more sense; Mr Clinton has always believed in the second and, despite a tussle within his campaign, seems to have stuck to his guns. The unanswered question is whether a Democrat who so delights in baiting Mr Jackson can count on a substantial black turnout in November. Black turnout was well down in the primaries this year.

As for Ms Souljah, she just baited Mr Clinton right back, accusing him on network television of being a racist. When asked whether she was one herself, she said "I don't think black people have the power to be racist." But they can have a good try.

Summer fun

All wet

DETROIT

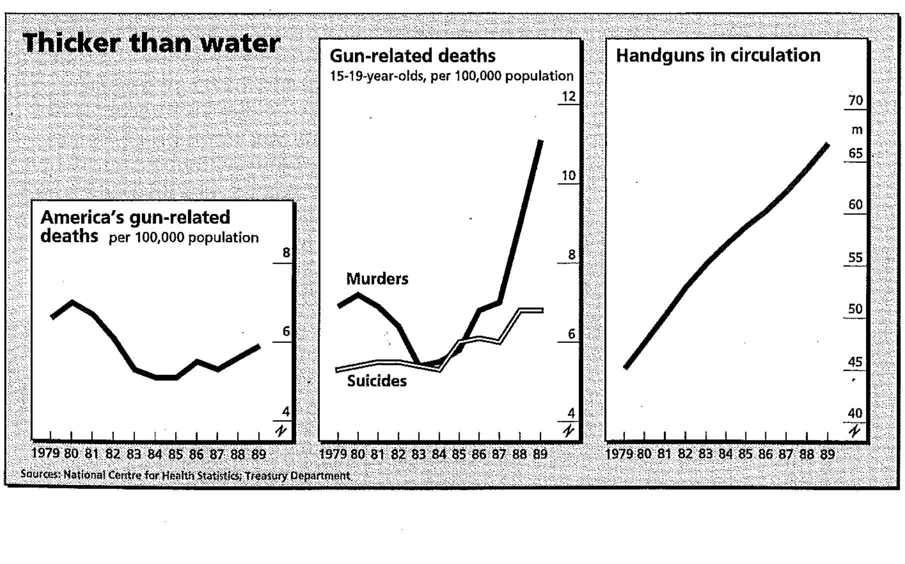


IN THE same week that saw the publication of some horrendous figures on handguns (see charts), Americans were getting exercised over a gun of a different sort. Despite the chilling statistics—that rates of gunshot homicide rose by 11% in 1987-89, and that 5% of male students routinely take guns to school—the only talk of banning involves a brightly coloured plastic toy that squirts water and makes people cross. The Super Soaker, as it is called, sells for about \$30. Some models hold prodigious amounts of water. They shoot jets of it for remarkable distances. They drench people. That is the point.

In calmer days water guns were considered a harmless, if sometimes mildly annoying, part of summer fun. They are still essentially harmless, but today the slightest insult can lead to tragedy. In Boston recently, a 15-year-old boy soaked another youth and was shot dead for his trouble. The mayor asked stores to stop selling the toys, saying they were a clever notion that had "gone sour".

Detroit has seen no revenge killings, but the region has been inundated with reports of drive-by squirtings, mostly of pedestrians and motorists at traffic lights. Police have worried aloud that drivers, enraged at being squirted, may resort to reckless driving. A local politician, Gil DiNello, apparently suspecting that the topic could be a vote-getter in this strange election season, has gone even beyond the mayor of Boston: he has demanded that the Super Soakers should be banned entirely.

Mr DiNello is also a strong opponent of gun control, at least the usual kind. When asked to reconcile his new proposal with his staunch defence of guns whose ammunition is bullets, he told the *Detroit News*: "Real guns are intended to kill. This is intended as a toy." This prompted some to wonder whether the manufacturers could win Mr DiNello's support if they advised purchasers to replace the water in the toys with hydrochloric acid.



Sources: National Centre for Health Statistics; Treasury Department

Scandals

Down memory lane

GREAT scandals never die; their leading characters simply grow greyer and crustier, their misdeeds harder to remember and their book contracts longer. For the past few weeks, as the 20th anniversary of the Watergate burglary has crept upon them, Americans have been gazing again at the wonderfully craggy face of Archibald Cox, the Watergate special prosecutor, now 80 and striding across the fields in his retirement; at Gordon Liddy, the chief of the White House "plumbers", his eyes blazing even as he sips a cup of tea; and at Richard Nixon himself, pasty but unbowed, advising butchers in Moscow how to chop a joint of beef. Old journalists and editors have been remembering how they first heard the story, and how they wondered whether to bother with it; but how it grew, gradually, into their finest hour. There has been nothing to match it since.

Certainly the Iran-contra affair always paled by comparison, although its scope was vast, covering most continents, and its mockery of the laws just as brazen. But the affair almost drowned in its own documents, the congressional inquiry was hurried and botched, and the criminal prosecutions have been achingly slow. The highest-level indictment has not come until now, when the statute of limitations is about to descend on the case for ever. The fish the special prosecutor has caught is Caspar Weinberger, once Ronald Reagan's secretary of defence.

Mr Weinberger protests his innocence; he was, as is well proven, an outspoken critic of the very idea of arms sales to Iran. Nonetheless, he has been charged with five felony counts for leading investigators to believe that he knew nothing about one particular shipment at the time it occurred, in November 1985, when his diaries suggest otherwise. The trail may lead onwards and upwards; if Mr Weinberger is found to have concealed what he knew, it may be that a

cover-up was condoned by Mr Reagan himself.

It seems curious, to say the least, that 1,700 pages of Mr Weinberger's diaries were not discovered or requested by the prosecutors before November last year, when they turned up in the Library of Congress. But the Iran-contra investigation was thrown off-course at the start by a decision, encouraged by the White House, to go for the smaller fry who had done the deeds, rather than the higher-ups who had gone along or condoned them. In Watergate, the prosecution homed in on the White House quickly, and did not flinch. That made it both a great story, and a great triumph for justice and the American system; so great a triumph, indeed, that the country has not since dared to go through such a thing again.

Cities

Carter in kudzu

ATLANTA

SINCE he left the White House, Jimmy Carter has become famous for doing good around the world. Yet his mind is not always on Central America or Eritrea; he is also trying to enlist volunteers for "Project Atlanta", an effort to fight crime and poverty on his own doorstep, in Georgia. Barely 100 yards from Mr Carter's gleaming presidential library the inner-city slums begin, dilapidated plywood huts half-askew in the kudzu vine that rampages over much of the South. Mr Carter has strolled out here to meet the poor, and he is insisting that others do so too.

Atlanta's economy boomed in the 1980s, and its image still glitters. Yet the Five Points district, once the commercial heart of the city and the financial centre of the South, is now full of abandoned buildings. A third of the city's families scrape by on annual incomes of less than $15,000. Violent crime has soared by 300% in the past five years. At Grady Memorial Hospital, nearly one-fifth of all babies are born to women who use cocaine. Jobs and middle-class people have moved to the suburbs; the inner city is now seen as both undesirable and unsafe.

The Atlanta project claims to be unique. It seeks to recruit thousands of volunteers to help teachers, work in health clinics, refurbish homes and act as probation officers in 20 of the city's poorest neighbourhoods. Some 2,000 people and organisations have offered to volunteer since last autumn, and the project has raised a five-year, $26m budget from grants and donations.

Mr Carter himself devotes two weeks each month to the project. He has appealed to the Bush administration to help cut red tape, and he constantly pricks the sense of guilt of affluent, religious whites, calling their churches "plastic shells" and "dormant elements of self-gratification". After one passionate Carter speech in March, the head of Atlanta's Chamber of Commerce found himself thrusting a $10 bill into the hand of a jobless man on the street.

The project, inevitably, has its critics. Some members of Atlanta's black churches doubt that Mr Carter and his 18 administrators, who are well-off blacks and whites, can fully grasp the needs of the poor. Other critics insist the project is doomed without more money. Still others, outside the chosen neighbourhoods, worry that their own volunteers and resources will be diverted. Even Mr Carter, who warns that measurable success may not be evident for years, acknowledges the potential for failure. But at least he is trying.

Spot the glittering towers

A national curriculum

Common knowledge

BOSTON

TEACHERS of first-grade American history in south-west Florida's Lee County are given this vague guideline for planning their curriculum:

> The child shall be able to identify and explain the significance of national symbols, major holidays, historical figures and events. Identify beliefs and value systems of specific groups. Recognise the effects of science and technology on yesterday's and today's societies.

But some have been using a framework that specifies which imporant people and events should be studied:

> Early Exploration: Columbus; Conquistadors; Aztecs. English Settlers: Sir Walter Raleigh; Jamestown; Mayflower; Puritans. Slavery in the early colonies: "the middle passage"; plantations. American Revolution: Boston Tea Party; Minutemen; Redcoats; Declaration of Independence. Westward Expansion: Daniel Boone; Louisiana Purchase; Cherokees; "Trail of Tears".

This second excerpt comes from a comprehensive curriculum for elementary education provided by the Core Knowledge Foundation of Charlottesville, Virginia. The foundation was established by E.D. Hirsch, an English professor at the University of Virginia, who argued in his 1987 bestseller "Cultural Literacy" that the declining educational achievements of schoolchildren in the United States were caused by the absence of a common body of knowledge taught in American schools.

Since then, he has helped to devise a remedy. For the past five years the Core Knowledge Foundation has worked with teachers to develop curricular guidelines for grades one to six that can be used nationwide. A Lee County principal was an early convert; in 1990 Three Oaks Elementary in Fort Myers became the site of the Core Knowledge pilot programme.

The United States is virtually the only industrial country without a national curriculum. The International Association for the Evaluation of Educational Achievement (IEA) consistently ranks American schoolchildren well behind their peers who learn a common core. According to Mr Hirsch, French and German national curriculums narrow the knowledge gap between privileged and poor or immigrant students as they go through elementary levels. In the United States, this gap widens: proof, to Mr Hirsch, that teaching a shared body of information, even one that reflects more on the mainstream culture, is not elitist but equalising.

The inadequacy of the present system

became clear from an experiment conducted by Mr Hirsch at a community college in Richmond, Virginia. When students failed to understand a short passage on Lee's surrender to Grant at Appomattox, their vocabulary or grammar was not to blame—they simply did not know who Grant and Lee were. (Bear in mind that Richmond was the capital of the Confederacy.) To use a favourite metaphor of the Core Knowledge staff, these students had been handed a can-opener but given nothing in the can.

The Core Knowledge programme is divided into five subject areas and arranged to provide continuity from grade to grade. Teachers receive lists of topics to be studied, but still choose their own texts. The programme is intended to comprise only half of a school's curriculum, in order to allow for local variation. Sensitive to criticism that "Cultural Literacy" was too Eurocentric, Mr Hirsch includes a wide range of references in his material; the speeches of Lincoln and Chief Joseph of the Nez Percé Indians are taught side by side.

Slowly, Mr Hirsch's ideas are gaining converts in both the suburbs and the cities. New programmes were added last September at Mohegan Elementary, a school in the depressed South Bronx where the pupils are 99% black and Hispanic, and at a private academy in Hanover, New Hampshire, where almost everyone is white. The Lee County district, which is 75% white, will convert another 20 schools to Core Knowledge next year. Chicago, Philadelphia, San Antonio, Oklahoma City and the Mississippi Delta are among other places where the curriculum will be field-tested in the autumn.

It is too early to assess how the system is working; but the principal at Three Oaks, who has now had two years of experience with the programme, reports encouraging signs. Attendance is up, suspensions are down, and the number of students held back has declined.

The mountain that eats Koreans

SEATTLE

ON THE afternoon of May 31st, four men inched slowly across an icy section of Alaska's Mount McKinley known as the Messner Couloir, 19,000 feet up the mountain. As a park ranger watched through his binoculars, one man slipped, and pulled down his companions with him. By the time they came to rest, 3,000 feet down, all were dead.

Almost every week this year, rangers have struggled out to bring back bodies from the tallest peak in North America. Since the climbing season began, in early May, 11 climbers have died. Ten have perished in falls; another, a Swiss climber, died of apparent heart problems caused by altitude as his wife brewed him tea in their wind-whipped tent. It has been the deadliest spring in the mountain's recorded history.

Mount McKinley (known as Denali, or "the high one" to native Athabascans) is a midget in the world of big-time mountaineering. But its vicious weather is unparalleled, and the exertion required to move supplies up the mountain leaves climbers weak and prone to miscalculations. Most deaths occur when they are making their way down.

Foreigners have been particular victims. Of the 28 climbers who have died since 1986, 26 were from countries other than the United States. A curiously large number are Koreans. Park Service officials have asked Korean climbing organisations to warn their members about the dangers of the mountain, but to little avail. One particularly treacherous spot, where a number of Koreans and Japanese have met their deaths after long, terrifying slides, has been dubbed "The Orient Express".

Louisiana

Faites vos jeux

HE PROMISED to "bring back the good times", and so he has. On June 11th, with his usual combination of strong arm and smooth-cheeked guile, Governor Edwin Edwards of Louisiana managed to persuade the state legislature to pass a bill approving the building of a giant casino in downtown New Orleans.

The bill was ostensibly the baby of Raymond "LaLa" Lalonde, a politician whose 1930s-bandleader appearance belies a passion for cock-fighting; but when its prospects began to slip, Mr Edwards stepped smartly in. The bill, revived on Monday, had passed both houses by Thursday. Members sitting at their desks in the chamber received personal calls from the governor; opponents were not allowed to speak; and the voting machine was turned off early. Huey Long would have been impressed.

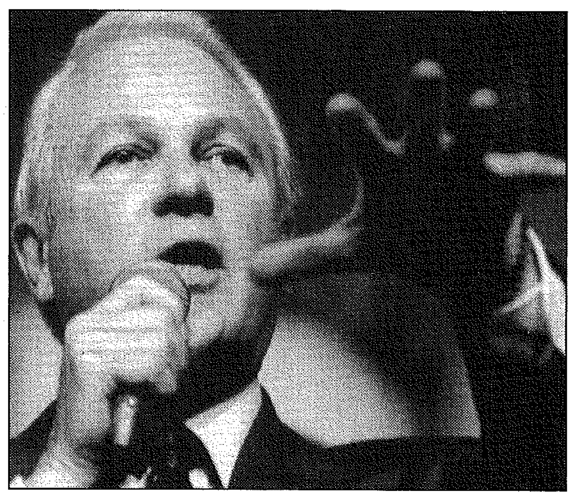
At first glance, Louisiana hardly seems to need any more gambling. It already has off-track betting, horse-racing, a state lottery, 24-hour bingo, the promise of video-poker in bars and approval for riverboat casinos. But Mr Edwards, a keen craps player, had to celebrate his election victory last year by hitting the tables in Las Vegas. During his campaign, which he fought as a reformed sinner, Mr Edwards said he would push for a casino only if the people wanted one. With the people uncertain, the governor's Perot-like pledge was soon revealed for the thin thing it was.

New Orleans now becomes only the third American city to boast a casino, after Las Vegas and Atlantic City. City fathers have long wanted one to revive the local economy, which has never recovered from the departure of high-paying oil jobs in the 1980s.

The figures on that front are impressive: the casino will provide perhaps 10,000 more jobs, and a fixed return to the state of $100m a year or 18.5% of takings, whichever is the greater. But New Orleans itself, a desperately poor place behind all that ironwork and stucco, gets a disappointing cut. No revenues may go to the city directly, apart from rent and service payments.

More important, New Orleans will have no control over how the casino is operated. After picking the developer (ten are bidding for the site at the run-down edge of the French Quarter), the city must leave it alone. The members of the casino commission will be appointed by Mr Edwards, as will the president. Profit-and-loss sheets will not be made public.

The mayor of New Orleans, Sidney Bartelemy, was not even able to ensure that New Orleans would have the only casino. The bill, as passed, leaves open the possibility of several. Mafiosi from the east coast (recognised, no doubt, by their inability to tell a gumbo from a jambalaya) have already been spotted circling in force.

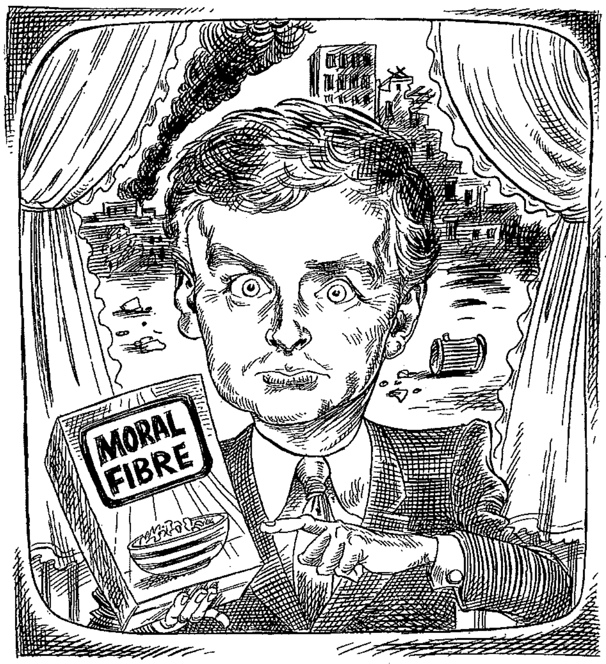


Edwards exultant

Dan, Dan, the morality man

MONDAY morning in Manhattan. Vice-President Dan Quayle has just called on Cardinal O'Connor for a chat about this and that: Lebanon, Yugoslavia, abortion (two days before, the cardinal has marched in an anti-abortion parade). Mr Quayle then walks to the Waldorf-Astoria hotel. And he is mobbed. Well-wishers cheer him; babies are thrust in his face; besuited executives yell "Great job, great job." Who would have thought it? After nearly four years in which poor Mr Quayle has been the butt of a thousand jokes, he has struck a chord.

He did it not by a sudden discovery of rhetorical skills; his speeches are still wooden. He did it not because, in embarrassing contrast to George Bush, he plainly loves talking about domestic policy. He did it by dropping one sentence into a speech in San Francisco on May 19th. "It doesn't help matters," said Mr Quayle, in a speech on the importance of "family values", "when prime-time TV has Murphy Brown—a character who supposedly epitomises today's intelligent, highly paid, professional woman—mocking the importance of fathers by bearing a child alone and calling it just another 'life-style choice'."



The message, as critics quickly pointed out, was somewhat confused; Mr Quayle seemed to be concentrating his fire on single mothers, who are, if anything, the victims of the crisis in values he was taking on. But that hardly mattered. "Murphy Brown" soon became mere shorthand for Mr Quayle's argument that the traditional family—a mother and a father raising their own children—was the bedrock of society. In the weeks since his first speech, he has elaborated the point, arguing first that those who mocked him were members of a cultural elite out of touch with mainstream America, and then (on June 15th) that the same elite had, among much else, been responsible for the decline of New York city. If any politician in America is having fun just now, it is Mr Quayle.

Part of all this is just clever politics. Mr Quayle knew he was going to be attacked by those liberals who, he argued, had subverted the family, and they handsomely obliged. ("Remote from reality", sniffed the *New York Times*, as if his speech smelled of rotten fish; "he seems seriously to believe that what poor people most need is moral fibre . . . The admirable values he asserts refer to a highly idealised world.")

But such attacks were the whole point; if Mr Quayle had not become a martyr to the cause, he could not have rallied the tired troops of social conservatism to his defence, and boy, have they rallied. In the rush to dismiss Mr Quayle's campaign as just another political ploy, inevitable comparisons have been drawn between him and Spiro Agnew, Richard Nixon's disgraced first vice-president, who campaigned against pointy-headed bureaucrats and intellectuals in the early 1970s.

Yet dismissing Mr Quayle's talk of family values as "just politics" will not wash. For all its many strengths, America has a set of social problems—persistent poverty and shockingly high levels of crime among them—whose intransigence seems linked (to put it most carefully) to family breakdown. As Nina Easton has just argued in the *Los Angeles Times*, the most reliable predictor of criminal behaviour and teenage pregnancy is neither race nor income, but the absence of fathers from their children's homes. Call the nuclear family a "highly idealised world" if you like; but it seems to do a better job of raising children at peace with themselves and the world than any other way.

The real weaknesses in Mr Quayle's position are two. The first is his assumption that the defence of family values is a prerogative of Republicans. Granted, that is easier to argue now than it would have been when Ronald Reagan, the head of a stunningly dysfunctional family (and the first divorced man ever to live in the White House), was president: but it is still bunk. When pressed on the question, Mr Quayle says that homosexuals and radical feminists will stop the Democrats talking about the importance of the family. But they haven't: every Democratic candidate this year had a speech about the importance of the family.

Moreover, Republicans, so keen to see a mote in the Democrats' eye, too often miss a beam in their own. There is no prouder aspect of the Republican economic record than America's remarkable job creation of the 1980s. Yet the flipside of that story is that more than 60% of women with young children now work. In Trenton, New Jersey, on the same day he took Manhattan, Mr Quayle visited the Luis Munoz Rivera school. There volunteers keep tiny children, whose parents work, occupied until nine o'clock, when most of them have to walk home through some pretty mean streets. The generosity of the volunteers was so heartwarming that nobody dared ask whether life might not have been easier for the children if they had been able to go home to a non-working parent in the afternoon.

Indeed—and this is a second criticism of Mr Quayle—too often his rhetoric on the family is no more than that. When pressed in New York on his view of parental leave from work, he replied that good employers granted it; but that it was not the government's job to tell them to.

If family values mean anything, however, they deserve support from government policies: changes in welfare rules, perhaps; changes in the tax structure to help the working poor; attachment of fathers' incomes for child support; even (though this would break the great American taboo) something that made divorce less easy to obtain. There is no shortage of ideas to back up the chatter about values; but few of them have, so far, been endorsed or explored by Mr Quayle. So the next time Mr Quayle walks down your street, give him just two cheers. He hasn't yet earned a third.

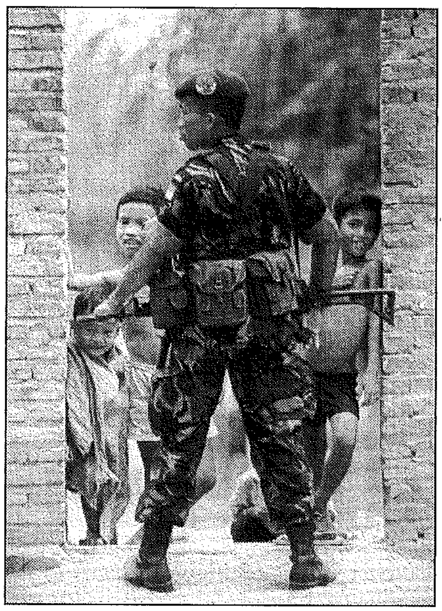
Cambodia's cause for concern

WILL Cambodia never be at peace? This month, according to the agreement signed by all and sundry in Paris last October, Cambodia's four rival armies—200,000 men—were to be disarmed while philanthropic foreign governments met in Tokyo to discuss the country's "rehabilitation and reconstruction". Instead, the Khmers Rouges announced that their guerrillas would ignore the June 13th deadline to assemble in camps under United Nations supervision and hand over their weapons. They could not, they claimed, co-operate with the UN's peacekeeping troops until they were sure there were no Vietnamese soldiers (perhaps masquerading as civilians) still operating on Cambodian soil. Not long afterwards, fighting resumed in the north of the country between the Khmers Rouges and troops of the government in Phnom Penh.

Such developments were always possible, even probable. The Paris agreement is meant to lead by April or May next year to free elections—and the Khmers Rouges, genocidal rulers of Cambodia from 1975 until Vietnam's invasion at the end of 1978, have no delusions about their electoral appeal. They had to be pushed to the negotiating table in the first place. If the signatures collected at Paris, which included those of 19 foreign governments, turn out to be worthless, the Khmers Rouges will not care.

But others should—and not just Cambodia's wretched civilians, terrorised by 13 years of civil war and its mine-strewn aftermath. The UN's peacekeeping operation in Cambodia is the most ambitious it has ever attempted: it involves 16,000 troops, 3,600 police and 2,400 civilians; its cost (up to the planned elections) is guessed at $2 billion, not including the reconstruction bills to be discussed in the Tokyo meeting due to begin on June 20th. Let the plan unravel, and one risk is that every subsequent UN peacekeeping effort will be prone to fray.

Another risk is that 70m Vietnamese, having at last set their course towards a market economy, will not enjoy its rewards. America has agreed to lift its trade and investment embargo on Vietnam and normalise relations only if the UN plan for Cambodia is implemented. Deprive Vietnam of the means to develop, and the prospect of integrating it into the prosperous Association of South-East Asian Nations becomes doubtful.



UNTAC unstuck?

But those are not the only dangers that will spill beyond Cambodia's borders. The head of the UN Transitional Authority in Cambodia (UNTAC) is Yasushi Akashi, a Japanese; the largest share of UNTAC's bill will be met by Japan; and by September, following a vote on June 15th by Japan's parliament to allow troops—under very restrictive conditions—to take part in UN peacekeeping operations, some Japanese soldiers could be deployed in Cambodia. None of this may appeal to Asians who remember Japan's behaviour before and during the second world war. But it is the first time Japan has taken a diplomatic lead and so encourages those governments, especially America's, which want rich Japan to help shoulder the world's political burdens. They realise that if Japan fails in Cambodia, it will be much less willing to try elsewhere.

Is failure now inevitable? Optimists argue that the years of war proved to the Khmers Rouges that a military victory is impossible, and that their sudden obduracy is designed to extract political concessions—notably by increasing the powers of Cambodia's Supreme National Council, on which the Khmers Rouges and the three other factions are represented. Since the increase would be at the expense of UNTAC, which is supposed under the Paris agreement to run Cambodia's main ministries until the election of a new government, the Khmers Rouges would be well placed to negate any decisions they disliked.

The optimists could be wrong. The Khmers Rouges have 35,000 or so well-disciplined guerrillas, and stocks of weapons and ammunition sufficient, it is said, for two years of fighting. Mr Akashi this week admitted that the ceasefire violations in the north were "pretty serious". Perhaps, he mused, the Khmers Rouges were worried that the conference in Tokyo would provide aid biased in favour of the government in Phnom Penh.

Whatever the reason, what should be the response? The Khmers Rouges' traditional ally is China, which during the civil war supplied Pol Pot and his men with arms and money to sustain their fight against the Phnom Penh government installed by Vietnam and financed by the Soviet Union. Times have changed: the Soviet Union is no more and China has ended its quarrel with Vietnam. Indeed, it was at China's urging that the Khmers Rouges finally talked peace—and doubtless America can persuade China to urge some more.

Yet China's persuasive powers may be limited. In chaotic and corrupt Cambodia the immediate influence on the Khmers Rouges is Thailand: its generals include men who connive in the logging and the mining of gemstones that enrich the Khmers Rouges. They are also the men who have protected Pol Pot, who has too much blood on his hands to remain leader of the Khmers Rouges in public. In other words, the Khmers Rouges may heed Thailand while ignoring China—and Thailand, after last month's anti-army political upheavals, is conscious of the need to appease international opinion.

Conceivably, such pressure could work. On June 16th the Thai foreign minister, Arsa Sarasin, met the Khmers Rouges' nominal leader, Khieu Samphan, in Bangkok and warned him not to "miss the boat" by undermining the peace process.

And if the pressure fails? In that case, the world could abandon Cambodia to its fate or send in troops to make peace rather than just keep it. Since neither option is palatable, the most likely outcome is a muddle: UNTAC will attempt to carry out the Paris accords without the Khmers Rouges. That would eventually give Cambodia an elected

government—whose army, its ranks doubtless strengthened with former guerrillas, would then wage war on the Khmer Rouge rebels. No one said Cambodia's peace would come easily, if it ever comes at all.

Thailand

Months of grace

FROM OUR BANGKOK CORRESPONDENT

THE caretaker prime minister of Thailand, Anand Panyarachun, has chosen a government of politically neutral technocrats. He says he will stay in office for no more than four months. Many Thais wish he and his team would stay for years.

Mr Anand, a civilian appointed by King Bhumibol in preference to a general, is trying to put the country back on a more or less democratic path after the army's bloody suppression of pro-democracy protests in May. The generals for once have had nothing to do with the new list of ministers. "They haven't got the right to ask for anything," Mr Anand told reporters. His interior minister and deputy prime minister is a former drug-busting policeman, Pow Sarasin. The sensitive post of defence minister has gone to a former army chief of staff, Banchob Bunnag, picked for his integrity.

Mr Anand has been prime minister before, chosen by the military junta that took power, under General Suchinda Kraprayoon, in February last year. He used his term (which ended with the general election three months ago) to try to curb corruption. Now he has less time and a tougher task. He needs to soften the impact on investors at home and abroad of the army's brutality. He wants to step down when Thailand has a government with a mandate won in fair elections. Because of an amendment to the constitution, his successor must be an elected member of parliament.

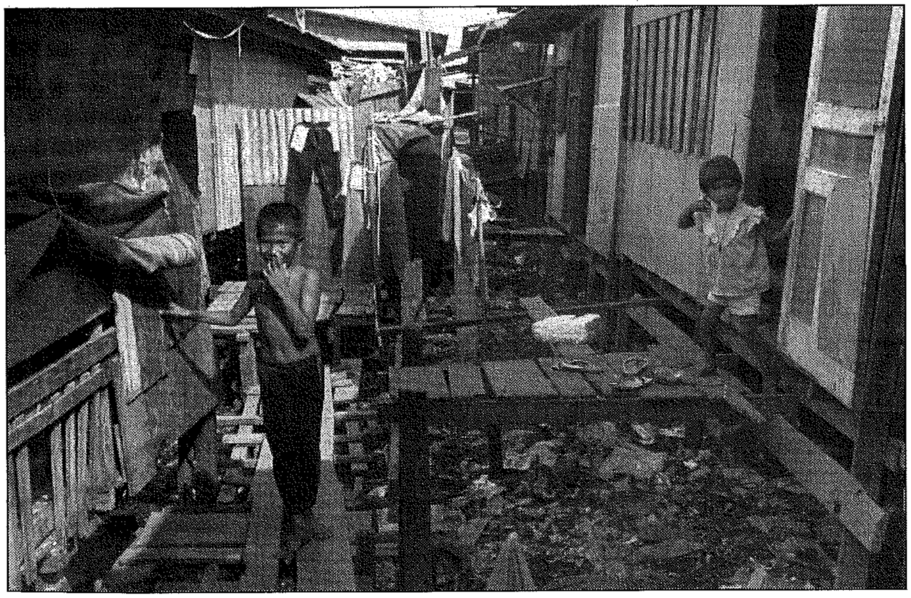
Mr Anand has been talking to the heads of an organisation set up to check abuses during the last election. He asked them what they needed to be more effective. His main help, however, may be that politicians have had little chance to replenish the funds they spent getting themselves elected only two months ago.

Many in the five-party coalition that backed Mr Anand's disgraced predecessor, the very same General Suchinda, are resisting moves to dissolve parliament. Others in the biggest party, the Samakkitham Party, which is financed by the air force, are trying to distance themselves from what they fear is an electoral albatross in order to prepare for re-election under some other banner. Chatichai Choonhavan, a former prime minister whose government's unrivalled corruption provided the excuse for General Suchinda's coup last year, is telling friends he would like a year or two more in politics. Even if Mr Anand delivers fair elections, the choice of candidates may not change.

Mr Anand wants to ensure that the abuses which contributed to last month's massacre cannot recur. That means tampering with the military's role in a political system the generals have dominated for 60 years. Four months hardly provides much room for manoeuvre. It could be less: Mr Pow said this week that elections would be held in late August or early September.

An investigation has started to try to discover who did what in last month's massacre in Bangkok, but Mr Anand remains circumspect on how he will meet demands for the culprits to be punished. General Suchinda, sheltering in an army base, has ventured out to a French restaurant under heavy protection but has not been to the investigation. The armed forces' supreme commander, Air Chief Marshal Kaset Rojananil, and the army commander, General Issarapong Noonpackdee, have also declined to appear in person, instead sending letters defending their actions.

Pro-democracy activists are waiting for moves to curb the generals' dominance of radio and television. Little of the demonstrations and gunfire broadcast around the world was shown on Thai television. According to a former British ambassador in Thailand, the king was alerted by his daughter, Princess Sirindhorn, who happened to be in Paris. Only then did he summon General Suchinda to be reprimanded.



A case for clean government

Japan

So rich, so poor

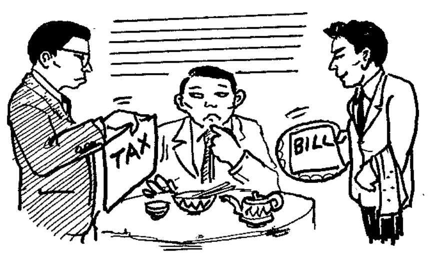
FROM OUR TOKYO CORRESPONDENT

ONE way to reduce Japan's trade surplus would be to get the Japanese to buy more foreign goods. Cut taxes and the Japanese would go on a spending spree with their extra cash, say America's trade negotiators. Japan's finance ministry disagrees. It claims the Japanese would simply save even more if they got a tax cut. This is probably nonsense. Many Japanese seem born to shop. But government officials believe they know what is best for the citizen.

The long-suffering Japanese are actually paying more tax then they used to. An economist at S.G. Warburg in Tokyo calculates that since April 1989, when taxes were "reformed", the amount a Japanese pays in income tax has grown on average by 14.5% a year. The average household income has risen each year by only 7.7%. In addition, social-security contributions have gone up by an average of 11.7% a year. Total household disposable income would have been 5% higher today without tax reform.

The reform cut the top income-tax rate from 60% to 50% and reduced the number of tax brackets from 12 to five to compensate for the introduction of a 3% consumption tax. But workers have become worse off because of what is known as "bracket creep": Japan's booming economy in the late 1980s catapaulted most people into higher tax brackets.

Since then the economy has braked sharply. On June 12th the Bank of Japan reported the steepest quarterly drop in business confidence since 1975. The high-taxed consumer cannot be expected to lead the economy to recovery. Japanese are indeed saving more. But part of that increase is to pay for yesterday's consumption. The Japanese, especially younger ones, discovered credit cards in the late 1980s. Between 1985 and 1990 gross average consumer debt per household (excluding mortgages) nearly



doubled to ¥450,000 ($3,550). Between April 1990 and April 1992 debt repayments on consumer loans (excluding mortgages) jumped by an average of 14.5%. The strains are showing. Some 40,000 people are expected to file for personal bankruptcy this year; the previous peak was 24,000 in 1984.

What with more tax and bigger debts and the falling value of land and shares, it is not surprising that consumer spending has been weaker over the past 18 months than the government and most private economists expected. Despite this, the ruling Liberal Democratic Party is unlikely to do much to ease the individual's tax burden. Its instincts are to favour a tax cut for companies first. And the party's many friends in the finance ministry would bemoan lost revenues. But income-tax cuts are surely an issue any half-alert opposition party would raise. Otherwise, consumer interests will continue to be represented best by foreign trade negotiators.

Rising sun

IT TOOK almost two years, but late on June 15th the lower house of Japan's Diet (parliament) brushed aside a last-minute attempt by the opposition socialists to resign as a block and passed a law that will allow up to 2,000 Japanese soldiers to take part in United Nations peacekeeping operations. Their first destination, is likely to be Cambodia. It will be the first time since 1945 that Japanese troops will have gone abroad for anything other than training.

The law grew largely out of America's frustration that Japan did little but write (large) cheques to help the allied effort against Saddam Hussein's invasion of Kuwait in 1990. Kiichi Miyazawa, Japan's prime minister, who presided over an embarrassing failure to pass an earlier version of the law late last year, has now had a moment of triumph, though he had to forsake a trip to the environmental summit in Rio de Janeiro to secure it.

Some will wonder what the fuss was about. Apart from providing logistical and medical help, the Japanese can do nothing—not even help to remove land mines, for instance—without the Diet's specific permission. Even so, a post-war Japanese taboo has been broken. And an Asian one, too: complaints poured into Tokyo from China, Korea and Taiwan. Half a century erases few memories in Asia.

Afghanistan

The game with no rules

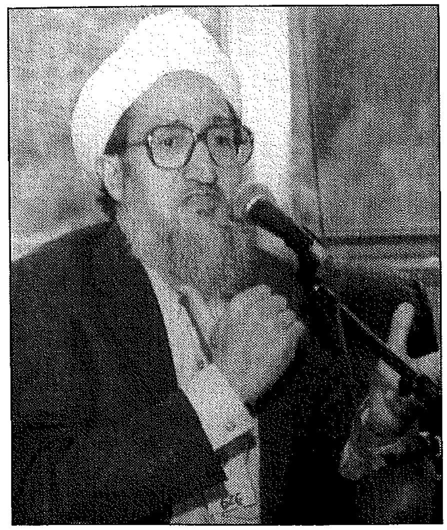
THAT their country could descend into Lebanon-like anarchy doubtless appals most Afghans. Yet, on the basis of this month's events, they may be powerless to stop it. On June 2nd fighting broke out in the capital, Kabul, between the Hizb-i-Wahdat, an alliance of Shia mujahideen drawn mostly from Hazara tribesmen, and the Ittihad-i-Islami, a largely Pathan band of Sunni Muslims. The two groups seized hundreds of hostages off the streets. By the time a truce was declared on June 7th and most of the hostages freed, scores of people, mainly civilians, had been killed.

If that smacks of Beirut in the bad days of the Lebanese civil war, nobody should be surprised. Kabul, too, is a microcosm of a patchwork country now unravelling. Different ethnic and tribal groups have always occupied different parts of the capital; now the distinctions have been etched deeper by the dozen or so mujahideen groups that swarmed into Kabul after the fall of President Najibullah in April.

Some of the mujahideen divisions are religious. There are Sunni and Shia Muslims, some moderate, others fundamentalist, some Wahhabis (like the Saudis), others Ismailis (followers of the Aga Khan). Other divisions are ethnic. There are Pathans, Tajiks, Uzbeks, Turkmen, Hazaras and Kirgiz—and their relations range from uneasy to hostile. All are heavily armed and ready to fight for what they see as their rights.

Already Afghanistan is split into fiefs centred on the regional capitals and the provincial towns. The government's writ extends no farther than the capital (and hardly even there). In Mazar-i-Sharif General Abdul Rashid Dostam, the Uzbek militia leader whose defection in April to the mujahideen precipitated the fall of Mr Najibullah, has his own air force of Migs and helicopters. Like an independent potentate, he negotiates export deals with the government of neighbouring Uzbekistan.

Meanwhile, confusion and impotence are the hallmarks of the new "government" led by the interim president, Sibghatullah Mujaddidi. On May 25th it appeared to have overcome its first big test. The defence minister, Ahmad Shah Masoud, signed a deal for "lasting peace" with the fundamentalist mujahideen leader, Gulbuddin Hikmatyar. Under the deal Mr Hikmatyar agreed to join the government, and to work for elections within six months (as agreed by most mujahideen groups in Peshawar on April 24th). Mr Masoud agreed to Mr Hikmatyar's demand that General Dostam's militia should leave the capital because the general once supported the communists—pretty rich, considering Mr Hikmatyar is himself allied to former communists.



Mujaddidi calls for time

But can the deal work? General Dostam, probably the most powerful man in the country, shows no sign of being ready to leave. President Mujaddidi has dismissed the idea of elections within six months as unrealistic (he is right: few of the 5m Afghan refugees in Pakistan and Iran have returned, and voters' lists will take time to draw up). He also claims that "the people" do not want him to step down in favour of Burhanuddin Rabbani, the leader of Mr Masoud's Jamiat-i-Islami, when his two-month term of office expires on June 28th.

As leader of the smallest Sunni mujahideen group, Mr Mujaddidi is too weak to stay on without the backing of someone stronger. General Dostam might do. This may explain why the president has promoted him to four-star general.

If General Dostam's men stay in Kabul, Mr Hikmatyar's forces, which are entrenched south-east of the capital, will presumably resume shelling it. If General Dostam supports Mr Mujaddidi's refusal to step down in favour of Mr Rabbani, his men could soon be fighting Mr Masoud's mujahideen—which would play into Mr Hikmatyar's hands. With so much uncertainty, small wonder that the majority of Afghan refugees are postponing the trek home.

Moscow gold

FROM OUR SRI LANKA CORRESPONDENT

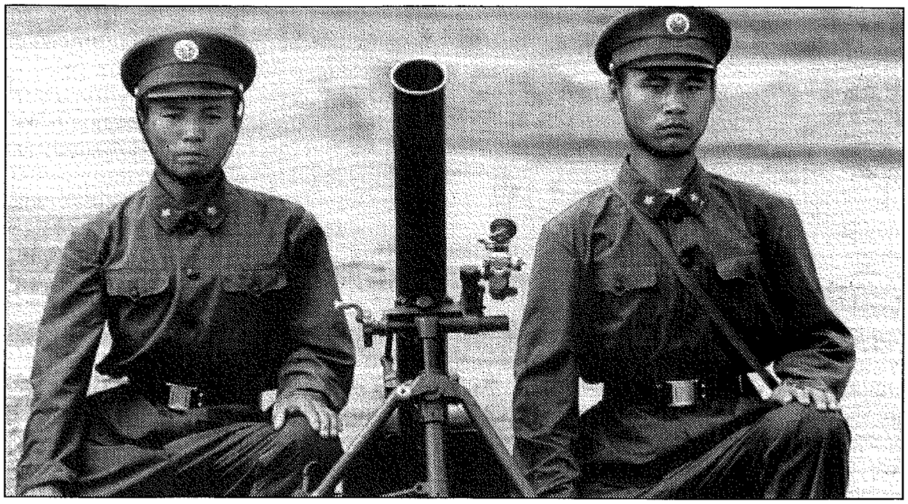
ACCORDING to *Moscow News*, the former Soviet government gave money to members of Sri Lanka's two main political parties during the 1989 general election. Sri Lankan newspapers are agog with the tale, the best to come their way for ages.

The Russian newspaper quotes a memo said to have been sent by the head of the secret service to President Gorbachev in March 1989. In it the KGB claims that, because of a donation, the opposition Sri Lanka Freedom Party of Sirimavo Bandaranaike increased its number of seats in parliament from eight to 67. The memo says that Mrs Bandaranaike promised that the increased influence would be used to block the pro-western foreign policy of the ruling party. Soviet money was also said to have been given to "people trusted by the KGB" within the ruling United National Party.

Mrs Bandaranaike, a former prime minister, told reporters: "I deny it completely. All this is nonsense." But the story has been received with glee by Sri Lanka's pro-government newspapers, which claim that the party was a puppet of the Soviet Union. The independent newspapers have given equal coverage to the money said to have been given to government politicians. For its part, the ruling party is trying to play down the story, showing rare restraint by declining to attack Mrs Bandaranaike over the issue.

The reason for the disclosure of the memo, assuming it is authentic, is to show Russians that the former regime wasted money. Discomfiting Sri Lanka was probably inadvertent.

Bandaranaike denies



Arms trade

Booming

ON THE face of it, the end of the old superpower tug-of-influence has been a boon to Asia. In Cambodia and Afghanistan outside powers have stopped stoking conflict and are trying to make peace. The region's giants, Russia and China, are now friends and have turned traditional enemies, such as Pakistan (for Russia), India (for China) and South Korea (for both), into increasingly valued diplomatic and trading partners. All this sits oddly with Asia's reputation as the world's busiest arms bazaar.

According to the Stockholm International Peace Research Institute, in 1991 the countries of Asia and the Pacific took 35% of world imports of large weapons, more than any other region, including Europe or the Middle East. The buyers were not just relatively rich countries, such as Taiwan, South Korea or Singapore. As the table shows, relatively poor India is by far the biggest spender on imported weapons (although some basket-case economies, such as Afghanistan, Cambodia and Laos, have in the past spent an even greater proportion of their GNP this way).

Both India and Pakistan have had some of their foreign aid trimmed because donor countries now take a dim view of their "excessive" military spending. The IMF talks of a notional spending limit on defence of 4.5% of GNP. Several Asian countries, including Pakistan, North Korea, Taiwan and Singapore, exceed it. Others, such as Afghanistan, Cambodia, Laos and Mongolia, would probably do so too if proper figures could be had.

But putting the squeeze on countries buying weapons will be hard. India depended for most of its imported weapons on the Soviet Union. The Soviet collapse threw India's defence procurement into temporary confusion, but now, despite India's budget difficulties, companies from America and both Western and Eastern Europe are queuing up to sell. These same companies face competition around the region from others auctioning off surplus stocks of Russian, Ukrainian and Kazakh aircraft, helicopters and tanks.

What is more, where risks are high or ambitions overweening, attempts to restrict arms imports—as everybody once tried with China, as China has tried with Taiwan, and as the West has done in blocking missile and nuclear technology to both India and Pakistan—merely nurture home-grown weapons industries. Last month India test-

Slings and arrows

	Arms imports, 1987-91		Military spending	
	$bn	as % of GNP	as % of GNP, 1989	Arms exports $m, 1989
India	17.6	1.3	3.1	–
North Korea	4.6	2.0	20.0	400
South Korea	3.6	0.3	4.3	40
Thailand	3.4	1.0	2.7	–
Pakistan	2.3	1.1	6.8	20
Taiwan	2.2	0.3	5.4	10
Indonesia	1.4	0.3	1.7	10
Singapore	1.3	0.9	5.1	70
China	0.8	0.0	3.7	2,000
Malaysia	0.1	0.1	2.9	–

Source: Based on G.Segal, *The Washington Quarterly*, Summer 1992, compiled from SIPRI, IISS, ACDA

fired its Agni missile, a medium-range ballistic missile. The Agni test was no doubt in part India's riposte to a Chinese nuclear test earlier in the month with an estimated yield of one megatonne (far exceeding the 150 kilotonne limit currently observed by Russia and the United States).

Part of Asia's problem is that it has five big powers—America, Russia, China, Japan and India—contending for influence. The Soviet collapse and America's lower profile have helped set these rivalries in motion. Add in Asia's usual variety of border and island disputes and there is plenty of old-fashioned insecurity to drive the weapons trade. Since the Gulf war, the equipment that countries want to buy includes fighter aircraft, "smart" weapons, more mobile tanks and artillery, and longer-range warships (including, in China's case, an aircraft carrier). With arms like those, even a small fight could do a lot of damage.

China

A theatrical man

FROM OUR CHINA CORRESPONDENT

FOR A man who turns 88 in August, Deng Xiaoping gives a remarkably spry performance on the political high-wire. Having extracted the mumbled endorsement of even his foes for faster economic reform, China's senior leader is seemingly getting his own men in place to carry it through. Yet the very flourish of Mr Deng's campaign shows how much resistance he must still overcome before the Communist Party's five-yearly congress this autumn decides who is to take over the running of China.

Mr Deng, after visiting the southern Guangdong province in January and February to laud its free-market spirit, had spread the word that he would withdraw from the public eye for the rest of the year. But in late May he was at it again. The patriarch paid a three-hour visit to Beijing's Capital Iron and Steel Corporation. He praised the state-owned company, a rare money-making version of that breed, for keeping itself relatively aloof from the government. He also took a swipe at those who pay only lip-service to reform.

But at least the lip-service exists—and is better than no service. Ever since the annual session of China's parliament in March, Li Peng, a prime minister with a mistrust of fast reform, has been forced to toe the Deng line. Then, on May 1st, Chen Yun, one year Mr Deng's junior and his main opponent among the elders, backed faster reform, at least in the rather special case of Shanghai. And on June 9th, Jiang Zemin, the Communist Party general secretary and a man who normally likes to sit on the fence, gave a public speech that duplicated Mr Deng's pronouncements to the letter.

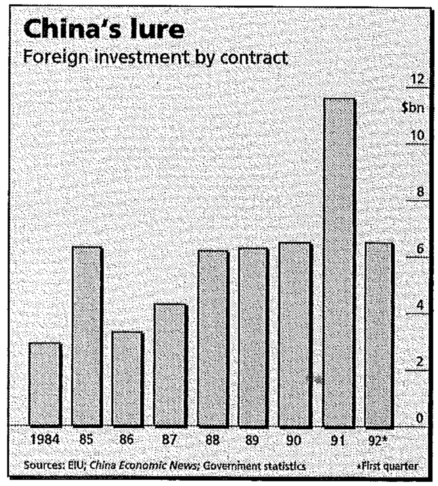
Yet the next phase of China's reform will stand or fall not on what happens to the successes of the 1980s—the booming private enterprises in the coastal provinces—but on the government's ability to spread that sort of success to the poorer inland areas and to reform the appallingly unprofitable state enterprises.

Document No. 4, duly rolled out by the party's Central Committee last month, tackled the first point by extending some of the tax and foreign-investment privileges enjoyed by the coastal zones to an additional 21 cities. Among them are provincial capitals in sensitive border regions next to Vietnam, ex-Soviet Central Asia and the Russian Far East and Korea; and interior cities along the Yangzi river (the best transport link between the heart of China and Shanghai). Foreign investment, which until now has been limited to manufacturing, will experimentally be allowed in services like insurance, banking and retailing.

As for state enterprises, the government this week issued regulations that will allow them to turn themselves into joint-stock companies. As "experiments", more than 3,200 enterprises have already done so, with most of their shares going to their workers, though a few to the public.

Modest ventures in housing and welfare reform have also begun, with the aim of providing a net to catch the unfortunates who will inevitably be shoved out of their jobs as state enterprises are "rationalised". None too soon: China's official press has been reporting strikes and violence by some workers affected by the early timid moves towards cleaning up state firms.

The reformist stir has added to the cheer



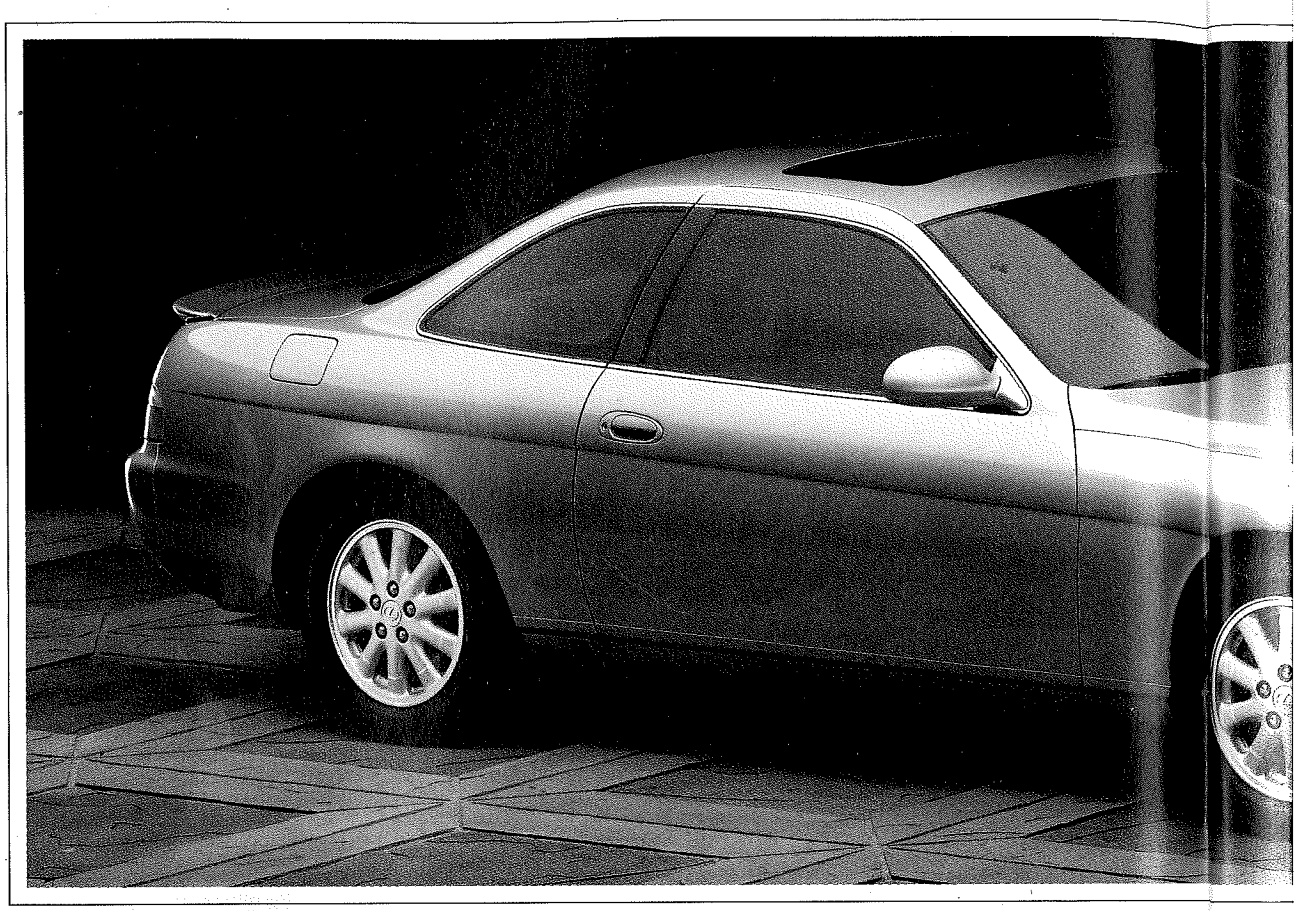
about China's economic prospects. The Hong Kong stockmarket, a surrogate for China in many minds, has risen by 36% this year, following a 42% rise last year. Some $11 billion-worth of foreign direct investment was committed to China in 1991 (and $3.5 billion was actually delivered); in the first quarter of this year $6.5 billion was committed, more than twice last year's pace.

Such optimism is a reward for Mr Deng's accomplishments in convincing virtually the whole of the leadership that the Communist Party cannot survive unless it delivers the economic goods. The logic would be more comforting if more of Mr Deng's men were in place to make it stick.

Maybe they soon will be. A new economics superministry, the Economic and Trade Office, has been created, headed by Zhu Rongji, a reformist deputy prime minister. Mr Deng apparently said, on his visit last month to the Capital steel factory, that Mr Zhu is one of the few officials "who really understands how the economy works". Could Mr Zhu therefore now be in line to displace Mr Li as prime minister?

The heads of other hard-liners have already rolled. He Dongchang was displaced earlier this month as party boss of the education ministry. And it was reported in Hong Kong this week that two other conservatives, the mayor of Beijing and the acting minister of culture, have also been sacked.

Excellent if true. But in a country whose politics is as corrupt and lawless as China's, personnel is usually a hotter subject of dispute than policy. Already this year Mr Deng has twice had to make theatrical gestures to overcome opposition to his plans for faster economic reform. His triumph, or his comparative failure, rests with those who will carry on the reforms—and they will not be known until the party reveals its list of promotions in the autumn congress.



So Much For Travel i

Take just one glance across the spectrum of new cars today and it isn't hard to predict where your eyes will stop. The Lexus SC 400.

As you can tell from the photo above, the unique design greatly con-

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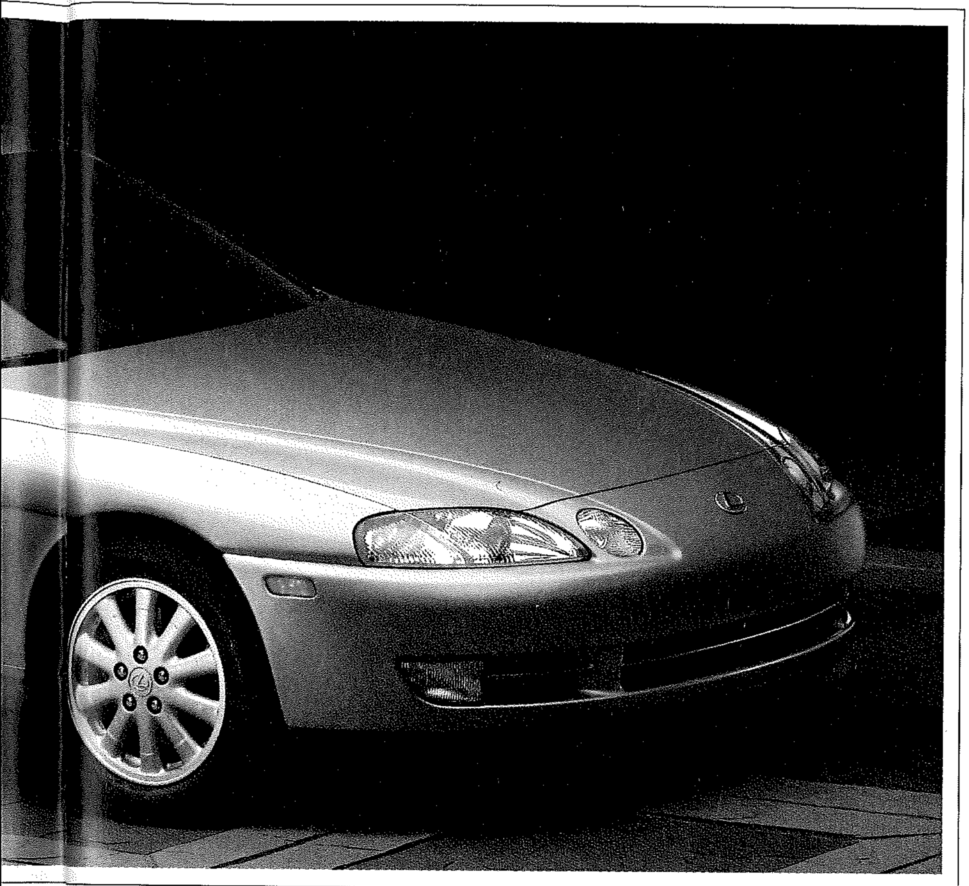

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tributes to this magnetism. What may not be so obvious, however, is the beauty that lies beneath the skin.

Such as a Four Cam 32-valve V8 powerplant that places 250 horsepower at your beck and call. Or the classic independent double-wishbone suspension that, in turn, is coupled to a technically advanced anti-lock disc brake system.

Sounds a lot like a muscle car, doesn't it. Yet the Lexus Coupe is far from being muscle-bound.

The leather seats, for example, conform to you, rather than the other way around. The climate control system will automatically maintain the cabin temperature to keep everything from your toes to your nose in complete comfort. And to accommodate your ears, a high-output, seven-speaker audio system surrounds you with sound few concert halls can duplicate.

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Because once you drive what *Motor Trend* named the 1992 Import Car of the Year, you must be prepared to answer a lot of questions. Autographs, mind you, are optional.

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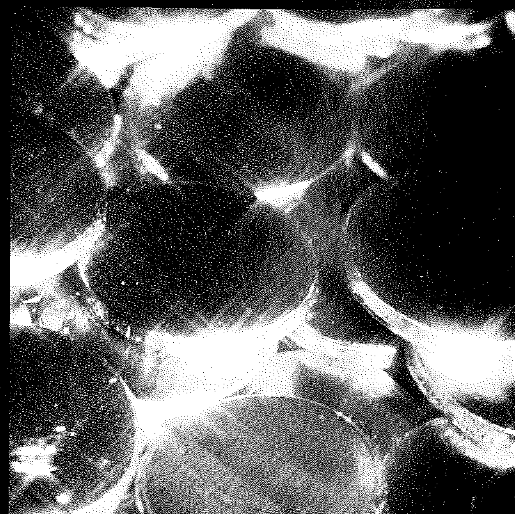


Coalition bricks without straw

FROM OUR SPECIAL CORRESPONDENT IN ISRAEL

A traditional king-maker passes on his way

LOCAL pundits call him Israel's Ross Perot, a plain-taking non-establishment politician who has somehow captured the public imagination. Mr Perot should sue. Rafael ("Raful") Eitan is not so much straight-talking as non-talking. A gruff former general, he campaigns by prowling uncomfortably through the streets, frowning at passers-by and brushing off the few supporters who have the temerity to approach him. "Raful isn't much of a talker," concedes one of his handlers. As for capturing the public imagination, Mr Eitan hopes that next week's election will boost from two to four, or maybe six, the number of seats his Tsomet Party has in the 120-seat Knesset.

The fuss over Tsomet reflects the peculiarity of Israeli politics. With an electorate finely balanced between right and left, and a system of proportional representation which put 15 parties into the previous Knesset, inordinate attention is concentrated on the quirky little parties that make or break ruling coalitions.

Hence the lack of excitement surrounding an election which might settle the fate of the current Arab-Israeli peace talks. Neither Yitzhak Shamir's Likud Party, nor a Labour Party rejuvenated under the leadership of Yitzhak Rabin, expects to win a simple majority on June 23rd. The next government will emerge from days or weeks of inter-party bargaining after polling day.

This year, in a half-hearted stab at electoral reform, Israel has raised from 1% to 1.5% the share of votes a party needs to win a seat. One result, to the left of Labour, has been the merging of three small liberal and socialist parties into a single party called Meretz. Tsomet, Tehiya and Moledet, to the far-right of Likud, continue to campaign separately. A handful of orthodox religious parties, the traditional king-makers in the centre, have merged as United Torah Judaism. Two others—Shas and Redemption of Israel—are campaigning separately. So (to the frustration of a great many Arab voters, see box on next page) are the three mainly Arab parties.

The real surprise of the campaign is that Labour is in with a chance. In March 1990 its then leader, Shimon Peres, marched out of the "national unity" government because he thought he had enticed the orthodox Shas Party into his camp. Shas double-crossed him and the manoeuvre backfired. Likud teamed up with the far-right to stay in power, Labour was thrust into the wilderness, and Mr Peres's reputation as a schemer grew. With Labour in the doldrums and Mr Shamir cutting a dash as the statesman who opened negotiations with the Arabs, a Likud victory looked inevitable.

No longer. In recent months two things have tripped Mr Shamir up. One is a swelling anti-incumbent mood, driven largely by economic misery (unemployment is at a record 11%) and a series of corruption scandals. The other is Labour's decision to ditch Mr Peres in favour of Mr Rabin. As a former war hero (and prime minister) on the right of the party, Mr Rabin has transformed Labour's standing among disenchanted Likudniks who could never have voted for Labour under Mr Peres. In this election Labour campaigners who used to be shouted down or chased out of Likud strongholds have been listened to with respect.

Nobody knows how many votes this respect might earn. Likud says its doubters have been returning to the fold as the election nears. It has been helped during pre-election week by a timely drop in inflation. But all predictions are blighted by the huge proportion of Israelis—more than 500,000, including 250,000 new immigrants, out of 3.5m—voting for the first time. Many immigrants, mostly from the former Soviet Union, are said to blame Likud for failing to create jobs and forfeiting $10 billion of loan guarantees from America. Young voters, traditionally on the right, are also showing an interest in the anti-clericalism of Meretz.

Mr Rabin's hope of becoming prime minister depends entirely on winning a "blocking majority" in the Knesset. A poll in *Hadashot* on June 18th suggested he would not get one. But if Labour, Meretz and the Arab parties—all of which are anti-Likud—receive more than 60 seats, the president will invite Labour to have first shot at forming a government. A snag to this is that Mr Rabin still refuses to break the taboo on bringing the Arab parties into a coalition. Unless he and Meretz do unimaginably well, he will almost certainly have to seek partners from elsewhere.

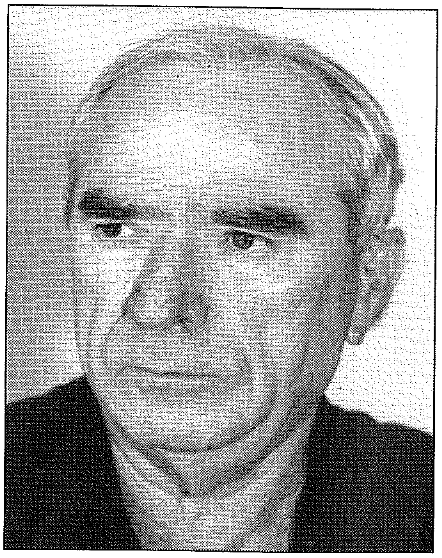
From where? The coalitioneer's first call used to be on the religious parties, which won 18 seats in 1988. They are scorned as opportunists by secular Israelis, who assume that with a blocking majority and a sufficient dowry Mr Rabin can bring them into marriage. That may be too blithe. The religious parties have drifted right, and are incensed by calls from prominent Labourites for an end to religious exemption from military service. Besides, Mr Rabin is not fond of them. "The stinking manoeuvre," was his description of Mr Peres's attempt to cut a

deal with Shas in 1990.

Mr Rabin's stronger temptation may be to offer Likud yet another "national unity" government of which he would this time be prime minister. On paper, Likud is as committed as Labour is to negotiating an interim "autonomy" deal with the Palestinians. Mr Rabin and Mr Shamir have worked together harmoniously in previous national-unity governments. The Labour leader may also calculate that progress will be easier with Likud inside the cabinet, rather than as part of a formidable anti-peace block, including the far-right parties and the West Bank settlers.

The prospect of another Labour alliance with Likud fills Meretz and some of the left-wingers of the Labour Party with despair. They refuse to believe a government containing an indomitable Greater Israeli such as Mr Shamir can freeze Jewish settlement in the West Bank, negotiate an autonomy agreement with the Palestinians or take any other steps for peace. They urge Mr Rabin to be "courageous", by which they mean they want him to do his utmost after the election to build a coalition without Likud.

Which brings the debate back to the lugubrious Raful. In Meretz and the Labour Party some tacticians now talk of finding salvation in Mr Eitan. Yet his Tsomet Party is on the distant right. It advocates Jewish settlement everywhere and promises to "help" those Arabs who want to emigrate. In peace talks, it says, no territory now controlled by Israel can be put forward for negotiation. No matter, say some in Meretz: if Raful can be persuaded that "autonomy" entails no immediate decision on borders, he can be talked into a Rabin government. It is not altogether outlandish. Like Meretz, Raful is an enemy of the religious parties and much of his popularity stems from his call for the orthodox to serve in the army.



Raful isn't much of a talker

In this election, Israel's peaceniks have accepted that most of their fellow-citizens are nervous of territorial compromise and mainly concerned with domestic issues. In Mr Rabin they have pinned their hopes on a tough-minded war hero, who can run mainly against Likud's domestic record and bring peace almost by sleight-of-hand. It is a pretty fragile experiment as it is. Adding Raful could test it to destruction.

Libya

A message for decoding

SNEER not; as a government tool, Muammar Qaddafi's third universal theory is hard to beat. Many a ruler has come to grief by being unable, or unwilling, to somersault a policy on its tail. Libya's hand-crafted theory of direct democracy, in which Mr Qaddafi is not the head of state but a leader who follows the dictates of his people funnelled through 1,500 Basic People's Conferences and distilled at the General People's Congress, eases the way for a volte-face.

The congress, which is supposed to be Libya's highest authority, has been given the job of deciding whether to hand over for trial in the United States or Scotland the two men, Abdel Megrahi and Amin Fhimah, who are suspected of having planted the bomb in the Pan Am airliner that exploded over Lockerbie in Scotland in 1988. At mid-week the congress, while still dithering, had provided plenty of clues.

Its chairman, who had opened the session by pointing out, as Mr Qaddafi and his men have done dozens of times before, that Libyan law does not allow the extradition of its citizens, got a terrible rubbishing by the Libyan press, which described him as a low-level fellow who did not know what he was talking about. The poor man, finding himself unexpectedly in disgrace, quickly ex-

Wasted votes

FROM OUR SPECIAL CORRESPONDENT IN ISRAEL

A CARTOON in an Arab newspaper in Nazareth shows a ballot box as a tombstone, with the epitaph: "1992: the Arab votes that were lost". If anybody stands to gain from Israel's system of proportional representation, it should be its 750,000 Arab citizens. The Arabs, with about 390,000 voters, could in theory control a dozen or so seats in the Knesset, giving them nearly as much weight as the Jewish religious parties. Instead the three mainly Arab parties are expected to win only a handful of seats on June 23rd, perhaps only two. Why?

The answer has nothing to do with turnout: a healthy 78% of Arabs voted in 1988. But the Arab population is deeply divided by religion, region and politics. There are sharp differences between Muslims, Christians and Druze; between town and village. As for politics, next week finds the Arab parties in a state of crisis. Hadash, the Israeli Communist Party (which has a smattering of Jewish members), is in decline. It will be hard-pressed to regain the four seats it now holds. Because of personal rivalries the two other Arab parties—Muhammad Miari's Progressive List for Peace and Abed Wahab Daroushe's Arab Democratic Party—failed to merge for the election. As a result it is possible that neither will win quite enough votes to get a seat.

This failure to merge, despite a trip to Cairo and strenuous mediation between the two men by Egypt's Husni Mubarak, has angered Arab voters and dashed their hopes of having a coherent impact on the outcome. In the past, four out of ten Arab votes have gone to mainstream Jewish parties, including Likud. That proportion seems certain to rise.

As the Communists decline, the Islamists are on the rise. One of their most impressive leaders, Abdullah Darwish, argues pragmatically that although the Jewish state is illegitimate, the Arabs of Israel should vote anyway. But, among Islamists, his is a minority view: the balance of opinion is that the Knesset has been a barren arena for Israeli Arabs.

On this point, if no other, the Islamists and the Arab secular parties are at one. Israel's Jewish parties observe an unwritten rule of excluding the Arab parties from their coalitions. The given reason is that they happen to pursue unsavoury policies: neither the Communists nor Mr Miari nor Mr Daroushe are accepted as loyal supporters of the state. But an element of racism is also at work.

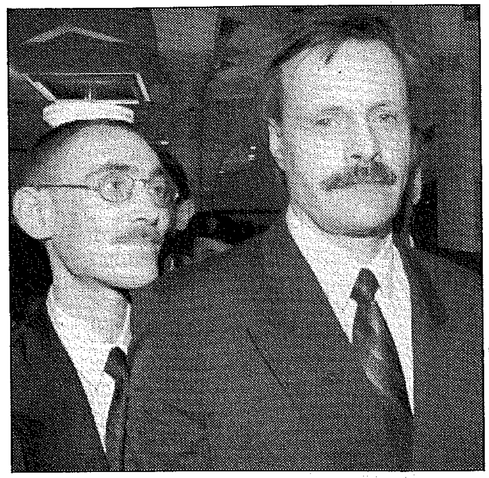
Over the years this has caused growing bitterness. Mr Miari has started for the first time to speak of Israeli Arabs taking matters into their own hands and setting up their own national institutions. With the *intifada* smouldering just across the vanished pre-1967 border, Israeli Arabs will not stay forever immune to the nationalism of their Palestinian brothers.

Last ones out

THE release of Thomas Kemptner and Heinrich Strübig on June 17th ends a squalid ten-year saga. During most of the 1980s any westerner brave or foolish enough to set foot in Lebanon risked being kidnapped by terrorist thugs paid for by Iran, sanctioned by Syria and acting in the name of God. Nearly 80 westerners were seized in this way. The kidnappers' demands were murky: the Islamic groups and their patrons wanted their friends released from prison, but they also wanted, and sometimes received, money and arms. By the 1990s the policy had been milked for all it was worth, and Iran, Syria and Lebanon began to win foreign-policy and economic credit by bringing it to a fairly swift finish.

The two Germans, captured in May 1989 as they were working for a charity helping Palestinian refugees in south Lebanon, were the last to go because the requested quid pro quo was embarrassingly direct. It was also a family matter: their captors, followers of a Hizbollah chief called Abdul-Hadi Hamadi, wanted the German government to release Mr Hamadi's two younger brothers: Muhammad, in prison for life for hijacking and murder, and Abbas, serving a 13-year term for an unsuccessful kidnapping bid. The Hamadis remain in prison, at least for the time being, but it may be made a bit easier for their family to visit them.

The Syrians, who had stage-managed earlier handings-over, this time left it to the Lebanese. It was convenient to demonstrate Lebanese "independence". Moreover, Lebanon has particular reason to get the Germans out of the country: there is valuable reconstruction aid from the European Community waiting on their freedom. Last-minute snags were negotiated by the UN's hostage man, Giandomenico Picco. But with the flare-up of fighting between Israel and Hizbollah, Mr Picco is unlikely to get anywhere with his remaining hostage task in Lebanon: the 250 Lebanese, plus Sheikh Abdel Karim Obeid, whom Israel is holding in captivity until it gets definite news of its four servicemen still missing in action.



Kemptner and Strübig had tried to help

"past policies".

Control of the press helps in turning policy inside-out. Earlier this month, Libya's state-controlled newspapers began berating Mr Qaddafi for forcing the Libyan people to chase the mirage of Arab unity, to champion Arab causes at Libya's expense and to make an enemy of the West. Enough was enough, thundered the editorials, Mr Qaddafi could go his own way, but from now on the Libyan people would give their own interests priority. Whether or not this was the prelude to radical change in Libya's policies, Libya's Arab neighbours are fearful that it may mean less money and fewer jobs for themselves.

For 20 years and more, lamented press and radio in an orchestral performance almost certainly conducted (and possibly composed) by the leader himself, Libya has been sacrificing its oil wealth for the sake of ungrateful Arabs and other Muslims who sneakily sucked up to the West, and were prepared to throw their benefactor to the wolves at its time of greatest need. The wolves are America, Britain and France, which in mid-April pushed the United Nations Security Council to order sanctions against Libya.

To get the sanctions lifted, Libya has to deliver the two Lockerbie suspects, help France in its investigation of four Libyans suspected of involvement in the 1989 bombing of a UTA airliner over Niger, and provide "concrete" evidence that Libya has renounced all support of international terrorism. Last month the Libyans announced formally that they had cut their links with terrorist groups and banished all terrorist training camps from Libyan territory. This month they went further. At a meeting in Geneva between Libyan and British diplomats, they passed on some fairly precise information about their dealings with the Irish Republican Army, giving details of their contacts and of the weapons and explosives they had delivered.

The sanctions against Libya, mainly a severing of air links, are not by themselves painful enough to force big changes—if these are, indeed, in preparation. The sanctions are inconvenient, but no more. But Libyans dislike the opprobrium, feel genuinely miffed that their money has gone on a miscellany of causes, Arab and otherwise, rather than on making life pleasanter for themselves—and deeply fear an American military strike. Their fears will have been intensified by the American Supreme Court ruling this week that it was perfectly constitutional to abduct people from foreign countries to bring them to trial in the United States.

Lesotho

King's move

FROM A CORRESPONDENT IN LESOTHO

IN THE old days most political activity in Lesotho had to do with South Africa, its all-encompassing neighbour. Now that relations with South Africa are less emotionally charged, Lesotho's rulers and ex-rulers (both royal and common) can devote themselves to a simpler squabble for power.

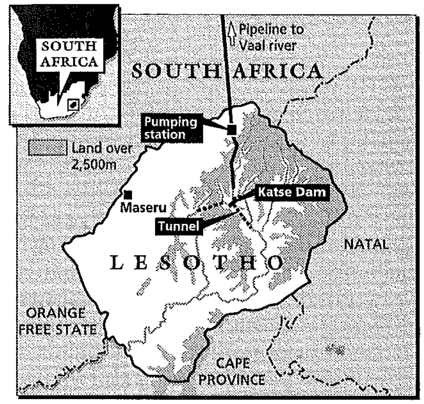
A military council has ruled the country since 1986. In 1990 the council's leader, Major-General Justin Lekhanya, expelled King Moshoeshoe II; the next year a band of army officers deposed General Lekhanya. The new leader, General Elias Rameama, has now called an election to be held on November 28th. General Lekhanya says he will stand for office, and King Moshoeshoe wants to return to his country—possibly to form a political party.

But the return of the monarch is a sensitive business in Lesotho. General Rameama, a self-educated soldier, is said to be jealous of the king, a scholar who has spent his years of London exile lecturing on Africa's democratic options. He should return, says the general, as a commoner, "like any other Mosotho (as the people of Lesotho are called) coming home to his family". A less-than-welcoming military greeting was feared. But, after a couple of days of negotiation in London, the military council announced that King Moshoeshoe could resume his reign on August 1st.

There is still a complication or two to be sorted out as the throne is technically occupied by his son, Letsie, who (although uncrowned) has been accepted by a council of elders as the rightful successor. Rivalries within the military council and between the traditional political parties keep the argument rumbling.

Tap in the attic

FROM A CORRESPONDENT IN LESOTHO



THE economics is simple. South Africa needs more water. Lesotho, enclosed completely within South Africa's borders, and exporting nothing much save migrant workers for South Africa's mines, has plenty of water in its mountains. Logically, Lesotho should sell water to South Africa.

The logistics are staggering. The aim is to divert the main flow of water by tunnel through the mountains, so that it flows north to the Vaal river rather than take its natural course west to the Atlantic. The dam across the steep Katse valley will be Africa's biggest, with a concrete wall 180 metres (590 feet) high and 700 metres wide. A fleet of trucks will have to cross mountain passes 3,000 metres high to build it, but the dam will eventually provide 63.6 cubic metres (14,000 gallons) of water per second for South African use.

The whole project will not be complete until 2020, and the first phase, which began in 1991, alone will cost $1.5 billion. Contractors from Britain, Italy, Germany, France and South Africa are helping. Eventually there will be five more dams and a hydro-electric station for Lesotho's own use, and enough royalties to provide every child in the country with free primary education.

The project will change Lesotho for ever. Villagers in the highlands will meet the outside world for the first time, not necessarily for the better. Sexually transmitted diseases are already appearing; AIDS is feared. Some people have been displaced and some farmland (in a country where only 13% of land is arable) disturbed. At least the pylons are bird-friendly, and there are schemes to protect the Maluti mountain minnow.

Political consequences are even harder to predict. Some fear that South Africa will eventually grow weary of paying for its water. It might then decide to incorporate the tiny Kingdom in the Sky, which would thus become merely the tap in the attic.

South Africa

Memory

FROM OUR SOUTH AFRICA CORRESPONDENT

BLACK protesters faced the white government's police, black workers stayed away from their jobs in white offices. On June 16th, the anniversary of the 1976 black student rebellion in Soweto, South Africa suddenly seemed to have turned back the clock. In Durban, 10,000 people marched through the city céntre, in Johannesburg 30,000 turned out to hear Nelson Mandela, president of the African National Congress, denounce President F.W. de Klerk.

Frustrated by months of negotiation and stalemate, the ANC has now taken the battle for democracy back to the streets. Ronnie Kasrils, a leading Communist and organiser of the mass action campaign (code-named "Operation Exit Gate"), says it will include an escalating succession of protest marches, strikes and sit-ins, culminating in a national strike, set tentatively for mid-August. The idea, according to Mr Kasrils, is to sweep the white government from power just as mass demonstrations toppled East European communists in 1989.

But South Africa is not Eastern Europe, and the ANC is not what it was before Mr Mandela's release two years ago. So while the campaign is partly intended to pressure the government into meeting the ANC's terms on a new constitution, ANC leaders also hope it will re-mobilise the organisation's own supporters (protests were in the planning stages even before the negotiations stuck). Both within the movement and outside it, South Africans see the campaign as the first real test of the ANC's ability to use its popular support for political gain.

It could fail. Months of talking have left the ANC rank-and-file feeling left out. The movement's leaders have had little contact with their constituents. And some seem less confident than they used to be. Mr Mandela recently told a meeting that the ANC could well lose an election to Mr de Klerk's National Party, which had more electoral experience, a better organisation and more resources. Others worry about the movement's vulnerability

Not as self-confident as Mandela looks

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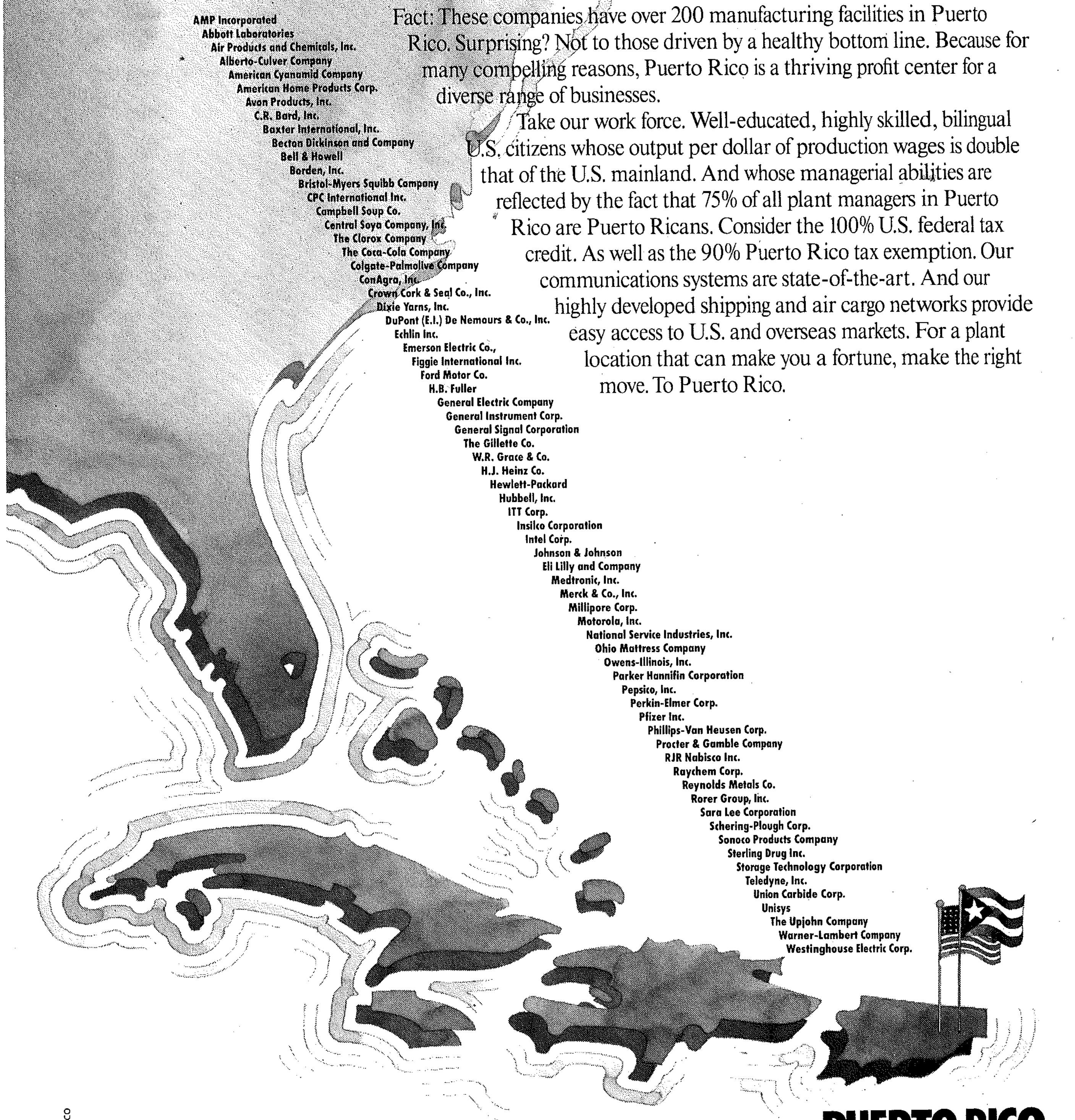

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to propaganda that portrays it as anti-Christian and in league with communists. As always, the ANC feels anxious about its failure to win white, coloured and Indian support.

The unity that the blacks once presented to the whites is also gone. The radical Pan-African Congress (PAC) and the Azanian People's Organisation have refused to participate in the protest campaign, claiming that it has more to do with the ANC's future than South Africa's. "We are not storm-troopers for the ANC," said one PAC leader.

But just as the ANC is not what it once was, neither are the groups that oppose it. True, some elements look familiar. As in the past, Mangosuthu Buthelezi, leader of the mainly Zulu Inkatha movement, is refusing to join the ANC's boycott campaign. And Mr de Klerk, sounding implacable, has urged all South Africans to "distance themselves from disruptive and undemocratic actions."

Yet the government has been damaged by recent allegations of corruption. A report by Amnesty International shows the police to have been more heavily involved in township killings than was previously admitted. Clearly, the police are feeling the need to appear more sensitive. When, last weekend, the police seized thousands of weapons (mainly spears and clubs) from Inkatha supporters—and later returned them, according to some reports—it looked like an attempt to seem more even-handed than was actually the case.

Mr de Klerk is more vulnerable than he pretends to be. If mass action deteriorates into mass violence—and dozens of people died in the first three days of the campaign—he will be blamed no less than the ANC. With so much invested in the success of the negotiations, failure would hurt him.

A string of protests could prove the tonic the negotiators from both sides need to get them interested in compromise once again. At the best, prolonged demonstrations and boycotts might help whites to remember what life was like before the rapprochement began; the ensuing violence might convince black leaders to return to the negotiating table before things get too angry. At the worst, mass action could leave the stalemate in place, but with more people dead.

Newfoundland

Ballicatter times

FROM OUR CANADA CORRESPONDENT

INTERNATIONAL law, stormed John Crosbie, Canada's fisheries minister, is "a gigantic ass." Yet the news for Newfoundland's fishermen is mildly good. Some 50 countries agreed at Canada's urging, during the Earth summit in Rio, to hold talks on the dwindling stocks of fish that migrate across the invisible lines marking the 200-nautical-mile (370-kilometre) economic zone allotted to coastal states. Fine, except that the conference will not produce early results and will certainly face resistance from the European Community; Spain and Portugal have a lot of ships hovering around the once-bountiful Grand Banks each spring.

Fish that know no borders

Another, relatively good, bit of news: an international tribunal in New York has awarded France only one-quarter of the 14,500 square nautical miles (50,000 square kilometres) it claimed seaward of its tiny islands of St-Pierre and Miquelon, off the south coast of Newfoundland. But the court also gave the French fleets an exclusive ten-mile-wide corridor running seaward for 200 miles, rather than the 12-mile ring around the islands that Britain received in a similar dispute involving the Channel Islands. This was the judgment that stirred Mr Crosbie's wrath.

Newfoundland, which has survived on fishing for 400 years, has hit hard times. Over-fishing by trawlers has so reduced offshore stocks that two years ago several large fish plants had to close. Inshore fishermen are in trouble too. A combination of too many fishing boats and unusual water temperature has drastically reduced the stock of northern cod.

The Northwest Atlantic Fisheries Organisation recommended this month that Canadian fishermen catch only one-third of last year's haul; Mr Crosbie has given warning that he may call a halt to all inshore fishing from July. This would bring calamity to nearly 1,000 small neighbourhoods—unless the federal government treats the inshore fishermen as the peasant farmers they are and their poor harvest like a drought, and replaces lost income in the same way it supports the Prairie wheat farmers.

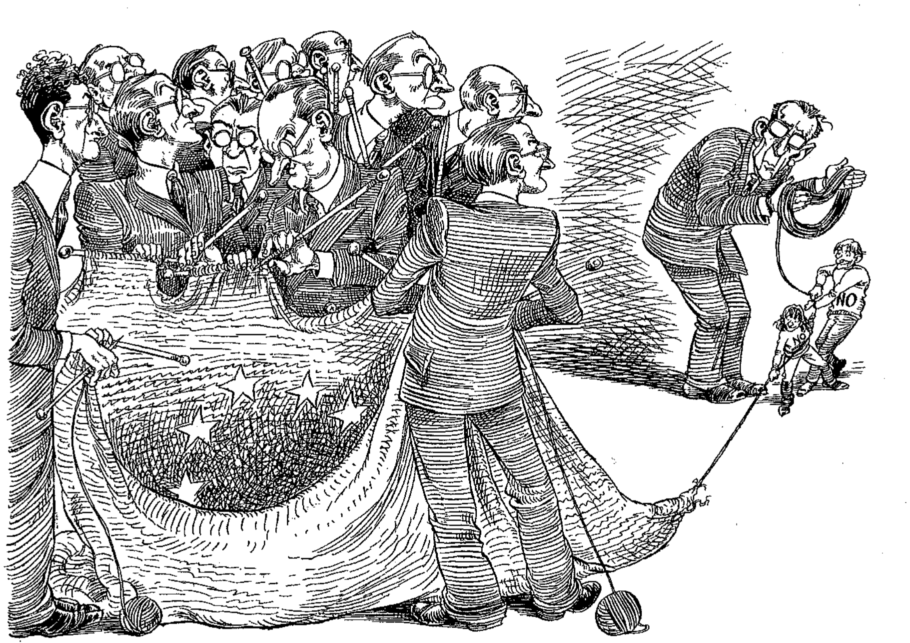
The larger question is whether Newfoundland can be anything without fish. Commercial fishing provides the province with its cash and jobs—and is the main reason for the current 20% unemployment rate. But it goes beyond this: Newfoundland's culture has been built on cod-fishing and the companion occupation of seal-hunting.

Anybody dipping into the "Dictionary of Newfoundland English" will discover a rich trawl of words describing the state of ice conditions (ballicatter, clumper or quarr) or the weather (pecking) or the rig of boats. Newfoundlanders as seafolk are individualists to the point where they have their own time-zone, half an hour at odds with every other zone.

Theirs, too, is a culture that thrives on the hardships of fishing from isolated outports. Herbert Pottle, the 15th child in a family where eight died in infancy, wrote a book on Newfoundland's humour, whose object he says is to "banish the baleful". Joey Smallwood, who dragged Newfoundland into confederation with Canada in 1949, worried that the day of union would release a flood of young Newfoundland men heading to the mainland to seek jobs and better times. He died last December, relieved that his fears had proved groundless.

Yet there has been more than a trickle of emigrants from this province of 576,000 people. Mr Smallwood's attempts to establish various industries, including an oil refinery at Come by Chance, were expensive failures. The pulp-and-paper industry is being undercut by American competition and the present recession has deepened the general distress. It will take the islanders' distinctive brand of humour to banish today's baleful thoughts.

EUROPE



Hoping for a stitch-up

FROM OUR BRUSSELS CORRESPONDENT

THE European Community, its plans for closer union badly snagged by Denmark's rejection of the hard-won Maastricht treaty, has not been in such disarray since General de Gaulle left an "empty chair" at the top table in 1965. His reasons would sound entirely understandable to today's Euro-sceptics: de Gaulle was protesting against the growing power of the European Commission and the spread of majority voting in the Council of Ministers.

For six months the French boycotted meetings. That dispute, like most in the Community's history, was between governments, which eventually stitched up a deal. The "Luxembourg compromise" gave de Gaulle some of what he wanted and broke the career of Walter Hallstein, the commission's brilliant but arrogant president, who was committed to European federalism. Might history be about to repeat itself?

The current crisis will be harder to resolve. This is not an argument among governments. Rather, it is a conflict that pits the 12 EC governments, which want the Maastricht treaty, against public opinion, which in some countries does not. Irrespective of the outcome in Ireland's Maastricht referendum on Thursday, uncertainty will last at least until the French referendum in the autumn (see page 49).

Meanwhile the Community's leaders will gather in Lisbon for a summit on June 26th and 27th. They are aware that without careful handling the Maastricht agreement may unravel. Thus they will try to avoid rows, while proceeding with business as usual. There is plenty to get through.

The two big items on the agenda are the future enlargement of the Community and the budget. Four countries from the European Free Trade Association (EFTA)—Austria, Sweden, Finland and Switzerland—have applied to join. Norway may follow suit in November. The four hope to start talks next year and to join in 1995. The Danish referendum result worries them all. Until its consequences are clear, they would not know what sort of EC they were trying to join. However, if the Danish problem can be settled quickly, and if the unravelling of Maastricht can be reversed, this crisis may yet speed up the entry of the EFTA countries.

Germany and Britain have always supported EFTA countries' bids for membership, while France has shown little enthusiasm. This year France realised that resistance to what seemed inevitable was pointless, and damaging to its relations with the would-be members. Even before the Danish vote, President François Mitterrand had talked of the EFTA countries joining rapidly. Since the vote, France's priority has been to maintain the EC's political momentum; it now wants enlargement to be hurried along, so that doubting Danes and bilious Britons see that the EC project is moving forward, with or without them.

At the Maastricht summit last December, the European Commission was asked to prepare a paper for Lisbon on the implications of enlargement. The commission's president, Jacques Delors, promised the European Parliament in April that EC leaders would get "a political, institutional and intellectual shock" when they read it. He never explained further what he meant, but his staff argued that the entry of EFTA countries would bring decision-making to a halt unless, at the same time, EC institutions were strengthened. Britain replied that such reforms should wait for the treaty revision due in 1996; France and Germany backed the commission.

This argument threatened to delay the start of entry talks with the EFTA countries. But the Danes have settled the matter. Everyone, including Mr Delors, now realises that the people of Europe are not yet ready for a further round of constitution-building. The commission has locked away earlier drafts of its Lisbon paper until 1996. The final version, rather than proving a shock, will be as mild as *vinho verde*.

The Twelve assume that the EFTA countries, when and if they join, will form a "first wave" of new members; a second wave—including Poland, Hungary and Czechoslovakia (assuming that country is still in one piece)—is unlikely to arrive before the end of the decade. The Lisbon summit will try to convince the East Europeans that they have not been forgotten. The commission is hatching plans that would allow these countries to have closer links with the EC before they become full members. Its ideas include more financial aid, better market access and association with EC foreign policy.

But progress on enlargement depends not only on solving the Danish problem. Spain says that it will veto talks with the EFTA countries unless there is a satisfactory deal on the EC's budget for the five years starting in 1993. In February the commission unveiled a plan that would raise the ceiling on EC spending from its current level of 1.2% of the Community's GDP to 1.37% in 1997. That would allow the budget to grow from 66.5 billion ecus ($87 billion) this year to 87.5 billion ecus in 1997 (at cur-

rent prices, assuming economic growth of 2.5% a year). The bulk of the increase would go on regional aid and a new "cohesion fund" for Spain, Ireland, Portugal and Greece.

Predictably, those four have welcomed the plan. But the other governments view it as over-extravagant at a time when most of them are struggling to control their own budget deficits. The Portuguese presidency has worked hard on the package. The outlines of a compromise have started to emerge, although one tricky question—Britain's budget rebate—has yet to be tackled. Both the plan to increase spending on foreign policy (aid for Eastern Europe and so on) to 6 billion ecus a year and the planned cohesion fund (worth 10 billion ecus over the five years) look safe. Everything else will be cut. The R&D budget and Mr Delors's pet scheme to spend money on "industrial competitiveness" face severe trimming.

Everyone now agrees that the 1.2% budget ceiling should be kept until 1995, and that by 1997 it should be less than 1.37%. Only Britain and Holland argue for no rise in the current ceiling. The final compromise may be close to the 1.32% that Mr Delors had initially suggested—before other commissioners overruled him.

Anibal Cavaco Silva, the Portuguese prime minister, who will chair the summit, wants agreement on budgetary principles

Ratification

FROM OUR SPECIAL CORRESPONDENT IN BONN

EVER since Danish voters disrupted the Pied Piper march to European union, the European Community has been suffering from a worsening plague of rats. "Rats" is how one senior German diplomat only half-jokingly describes all those pests now emerging to question the Maastricht treaty he and his EC colleagues so brilliantly put together. The trouble with tackling this infestation is that the rats are appearing in all shapes and sizes, and in the least expected places.

Politicians—not least in Denmark itself—are still struggling to understand quite why the Danes rejected Maastricht in their referendum on June 2nd. The voters appear to have had a whole range of misgivings rather than any single, overriding objection. That makes it hard to invent a formula that would send Danish rodents meekly back into their holes.

It also makes it easy for others to read their own prejudices into the Danish vote. The British government (see Bagehot, page 60) suggests that everything might be alright if it was made clear that John Major definitively defeated federalism at Maastricht. German politicians of left and right argue the opposite: that Maastricht is merely a "stepping stone" to a more federal Europe. This idea is supposed to reassure Maastricht-sceptics, who are assumed to be distressed that the treaty does not give enough power to the European Parliament or create enough of a single foreign policy.

In other words, views on the Community's future—United States of Europe, or glorified free-trade area?—are as wide apart as ever. But Germany and Britain have moved closer in one respect. Both are now having to cope with a rat epidemic. For Germans, hitherto unquestioningly pro-Europe, this is new and unsettling. Maastricht, says a top economic official, is "in big trouble" in Germany. If Germans were given the chance to vote on the treaty in a referendum (which, it seems, they won't be), it would stand a good chance of being rejected. Many people are starting to ask aloud what they get from Maastricht in return for what it obliges them to give up.

What they are giving up is the D-mark. For Germans, with no royal family and little pride in their flag after Hitler, the D-mark has become a powerful national symbol. It embodies their post-1945 success; it is the prize East Germans voted for in 1990. What, give it up? For a foreign-sounding thing called the ecu? It is not only ordinary folk who are appalled at the idea. Last week 60 professors of economics—the sort of people Germans take seriously—issued a joint criticism of the Maastricht plan for economic and monetary union (EMU).

In theory, all the mainstream political parties back Maastricht, though on their recent behaviour you would hardly think so. A spokesman for the opposition Social Democrats called the professors' attack on EMU "a bit overstated, but not so bad", and described the government's attempt to pretend that it was business as usual after the Danish referendum as "whistling in the wind". The party had already forced the government to give the German parliament the right to take stock of Maastricht's implementation before the planned move to monetary union in the second half of this decade. Now the Social Democrats want to make the parliament's future verdict legally binding. This would in effect give Germany an EMU opt-out and undermine the supposed "automaticity" of monetary union.

The partners in Helmut Kohl's centre-right coalition government are also becoming awkward. There is a whiff of rebellion among the Bavarian conservatives. And Count Otto Lambsdorff, leader of the Free Democrats (liberals) and never an EMU enthusiast, alarmed the chancellor last week by suggesting that the Maastricht treaty might have to be adjusted in the wake of the Danish referendum. The count reckons it would be undemocratic and illegal for the Community to ride roughshod over the wishes of Danish voters.

Mr Kohl needs cross-party support for the two-thirds majority required to get the constitutional changes related to Maastricht through parliament. He also needs the support of the governments of Germany's *Länder* (regional states), who make up the Bundesrat, the second chamber of parliament. The *Länder* are playing hard to get, bargaining for a big say in EC decisions.

Few doubt that Germany will in the end ratify Maastricht on schedule, in the autumn (assuming the treaty has not by then suffered death by referendums). Still ardent Europhiles, despite the Maastricht doubts, German officials insist that they will not be the ones to rock the EC boat. But the strength of unease over EMU is unsettling, especially at a time when Germans are struggling with the strains of unity. The far-right Republicans are gleefully contemplating the gains to be made by presenting themselves as the only party campaigning to save the D-mark.

All this is forcing the government to explain for the first time why Maastricht is good for Germany. Mr Kohl is convinced that united Germany must be snuggled into a united Europe. Failure to grasp the opportunity now, he said this week, could set back the cause of European union 25 years or more. Theo Waigel, the finance minister, insisted that Germany will not allow any relaxed interpretations of the Maastricht standards that countries must meet to qualify for EMU.

In one of their very rare joint initiatives, the big three German banks—Deutsche, Dresdner and Commerzbank—have launched an attack on the 60 anti-Maastricht professors. They accuse the professors of still living in the 1970s, of failing to see a single currency as a "natural extension" of the European Monetary System and of underestimating the danger that the Community will break up if it does not forge ahead now.

Belatedly, Germany is getting a real debate on Europe. Thanks to the rats.

rather than numbers, lest the atmosphere turn sour. The leaders will hope to strike a final deal at next December's Edinburgh summit. But they are unlikely to do so unless the Maastricht treaty by then looks viable. Several parts of the budget package—such as the new cohesion fund—are based on sections of that treaty.

The debates in Lisbon will lead nowhere if the Maastricht agreement unravels. Many governments consider Britain to be as big a threat to the treaty as Denmark—especially since the opposition Labour Party seems to be swinging back to its anti-European past. If Britain, or any other country, cannot ratify Maastricht, the EC could well shrink before it enlarges. France and Germany are already laying plans for a hard core of countries to push ahead on their own.

The Lisbon summit looks set to reappoint Mr Delors, whose term expires next January, for a further two years. That would give him a total of ten years in the job, making him the longest-serving commission president (Hallstein held the job for nine years). That is unless history, this time in the shape of Europe's voters, intervenes.

France

Another Non?

FROM OUR PARIS CORRESPONDENT

THE French like to think they invented Europe. France was, with Germany, joint architect of the plans for European political union. Surely France's referendum this autumn on ratification of the Maastricht treaty ought to be a foregone conclusion? It isn't. That is partly thanks to the confusion sown earlier this month by Denmark's rejection of the treaty and partly a reflection of the low opinion Frenchmen have of their Socialist president, François Mitterrand, who wants a Yes vote.

A referendum had always been a possibility in France, but it became a political necessity after the Danish vote. The anti-Maastricht voice in France, although still a minority one, was eloquent, passionate and growing. It looked as if Mr Mitterrand would not be able to obtain the three-fifths majority of both houses of parliament needed for ratification. A referendum was a way of overriding these obstacles. It was also what the Euro-sceptics, including the neo-Gaullists, had long been demanding. By making what looked like a magnanimous concession now, Mr Mitterrand could avoid having his hand forced later.

By calling the referendum, Mr Mitterrand also forced a public wedge between his opponents on the right. Mr Valèry Giscard d'Estaing, leader of the strongly pro-European Union pour la Démocratie Française (UDF), immediately called for a Yes vote. Jacques Chirac, leader of the more Euro-sceptical, neo-Gaullist Rassemblement pour la République, shilly-shallied. He had to decide whether to follow his own instincts and advocate ratification, at the risk of seeing his party rent asunder, or to abstain (or even call for a No vote) at the risk of damaging his alliance with the UDF.

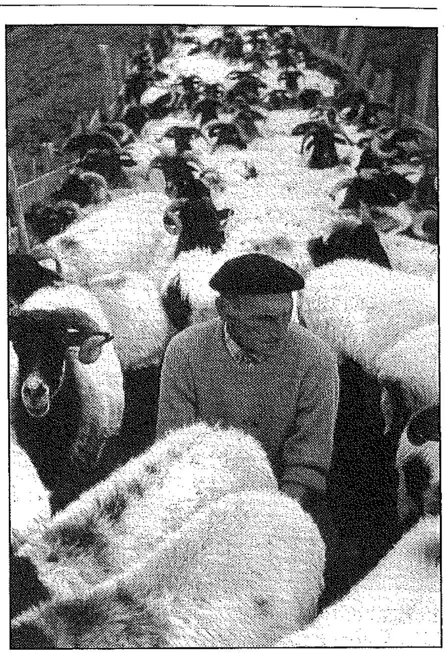
Mr Chirac tried a diversionary tactic. On June 8th, the neo-Gaullists demanded that their conservative allies withdraw from a series of pro-Maastricht meetings (organised long before Mr Mitterrand's referendum announcement) at which UDF leaders are due to share a platform with Socialist ministers. To persist would lead to "grave consequences for the union of the opposition", growled the neo-Gaullists. Greatly irritated, but not wishing to provoke open warfare, the UDF ignored the ultimatum. Instead, it has called on the neo-Gaullists to campaign for a Yes or risk the "progressive dismantlement of Europe".

The neo-Gaullists are still in a dither. Mr Chirac, who originally described Maastricht as "a small step in the right direction", now says that he needs more time to make up his mind. Support for a Yes vote has not been ruled out, but with the anti-Maastricht forces in his party growing, Mr Chirac will probably opt for abstention or an outright No, in order to preserve his authority as party leader.

The divisions of the right have also reopened personal hostilities between Mr Giscard d'Estaing and his former prime minister, Mr Chirac. Both men have their eye on the presidency. Mr Giscard d'Estaing, until now lagging well behind Mr Chirac in the polls, hopes the Maastricht debate will bolster his cause. Yet both know they will have to patch up their differences quickly after the referendum if they are to fight the general election due next March under a united banner.

And what if Mr Mitterrand's referendum gamble is lost? The polls suggest that 35-45% of the French would vote Yes to Maastricht, and around 25% No, with another 25% undecided and the rest abstaining. But the No vote has been growing and could easily grow a lot more. The curiously heterogeneous anti-Maastricht lobby embraces the Communist Party, the far-right National Front, many neo-Gaullists, some greens, a few Socialists and a handful of the UDF, as well as discontented lobby groups like hunters and farmers. This offers something to voters of all hues—including the idea that the referendum is as much a vote for or against their little-loved president as one on European union.

A No would put Mr Mitterrand under pressure to resign, as General de Gaulle did after losing his referendum on regionalisation and Senate reform in 1969. A Yes could leave the president strengthened enough to exploit the opposition's disarray



A very French muddle

and call a snap general election. While an outright Socialist victory would be too much to expect of a party that won only 18% in regional elections last March, a pro-Europe coalition of Socialists, centrists, liberals and greens under the leadership of some such emblematic figure as Jacques Delors could emerge. At present the opinion polls show that the two main centre-right parties could still expect a landslide victory, despite their differences over Europe. But after the referendum, who knows?

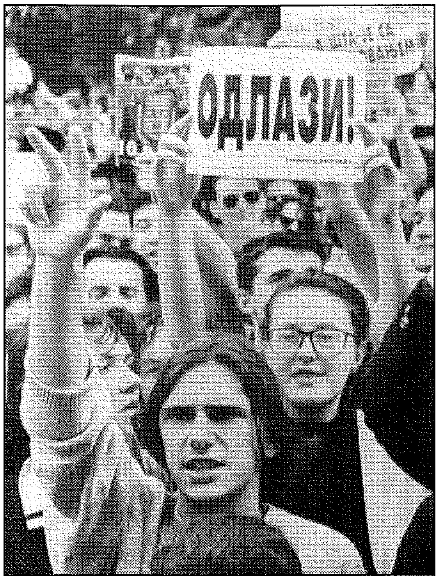
Serbia

A bully, but our bully

PETROL, cooking oil and sugar are beginning to run out; demonstrators have taken to the streets. Serbia's leader, Slobodan Milosevic, has told journalists he might be willing to step down if the opposition grows too big. Have the Serbs at last begun to tire of Mr Milosevic's wars?

No, is the short answer. True, waves of peace marchers have recently been descending on Belgrade. On June 14th, Patriarch Pavle of the Serbian Orthodox church led 6,000 demonstrators through the city centre. The following day 10,000 students, backed by their professors, called for Mr Milosevic's resignation. The newly united opposition plans a series of mass rallies.

The anti-Milosevic forces' ability to organise was new, but their ranks are not dramatically swelling. Most of the protesters are middle-class and educated, members of the one group that has opposed Mr



Translated: Go away, Milosevic

Milosevic's ambitions from the beginning. Their dislike of the ruling regime has still failed to filter down to Serbia's workers and peasants, some of whom were shown on state television holding pro-government demonstrations during the church protest march. And even among the middle classes, those who are willing to protest have not convinced others, many of whom still prefer to defend Mr Milosevic. He may be a bully, is the feeling, but at a time when the world is against us, he is our bully.

He would also be hard to drive from office. Recent elections, despite being boycotted by opposition parties, stengthened his position. And on June 15th the remaining delegates of the old federal parliament elected Dobrica Cosic, a Milosevic ally, to the new "Yugoslav" presidency.

Yet the regime is getting nervous. Armed militia now roam the streets of Belgrade, foreign journalists have been intimidated, arms are reportedly being given to Mr Milosevic's supporters. All this gives rise to fears of civil war within Serbia itself. But, short of a massive upheaval or a coup, the mechanism to oust Mr Milosevic is unclear.

Only economic crisis provoked by United Nations sanctions could bring about enough unrest to end Mr Milosevic's reign. The sanctions are already biting. When workers have to be sacked because energy to run their factories is no longer available, they may turn against their leader. That has not happened yet.

How long Mr Milosevic retains control over Serb troops is another question. His claim not to direct Serb irregulars in Bosnia is at least partly disingenuous—he has not done much to stop them—but also contains some worrying truth. Bosnia, the centre of former Yugoslavia's arms industry, provides plenty of weapons and ammunition to keep both sides fighting, independently of Mr Milosevic and of UN sanctions. Serb warlords in the region can battle on without help from Serbia itself.

Recognising this, UN peacekeepers are talking directly to local Serb leaders. They hope at least to clear artillery from the region around Sarajevo airport in order to bring in relief supplies to the local people, trapped in the city for nearly three months. A shaky, two-day ceasefire was negotiated on June 15th but shelling soon intensified. Exasperated by the world's unwillingness to send troops to confront the Bosnian Serbs, who have seized control of about two-thirds of its territory, the Bosnian government has now turned to Croatia in search of an ally. The two have formed a military alliance and this week forces from Croatia were fighting on Bosnian territory. The war—like Mr Milosevic—goes on.

Third thoughts about the EFA

FROM OUR BONN CORRESPONDENT

THANKS to a behind-the-scenes battle in the governing coalition, Germany may yet agree to stick with the four-nation European Fighter Aircraft (EFA) project—at least for a time. With a cabinet decision pencilled in for July 1st, backers of the cash-gobbling warplane, which is intended to come into service in the late 1990s, are redoubling their efforts to win a reprieve.

Ever since the new defence minister, Volker Rühe, began dropping heavy hints that he could find better uses for his money than ploughing more of it into the EFA, most pundits have been expecting Germany to pull out. Squeezed by the costs of German unity, the government badly needs to make cuts somewhere and the EFA, originally designed when the East-West battle lines were clearly etched and now reckoned by most Germans to be superfluous, is one of the few popular targets. The premier of Brandenburg, Manfred Stolpe, even won applause this week for refusing to attend the opening of an aerospace show where a big wooden model of the plane was on display.

Surely the finance minister, Theo Waigel, must be overjoyed at Mr Rühe's stand (especially since few other ministers seem as thrifty)? Not really. Besides his finance job, Mr Waigel is also chairman of the Christian Social Union in Bavaria, where most of the German aerospace industry is concentrated. Dropping out of the EFA would pose a threat to Bavarian jobs and to the booming tax revenue the project would help guarantee. It would also mean Germany had in effect made a gift of its hefty R&D spending so far to its project partners—Britain, Spain and Italy—which may well struggle on with the EFA even if the Germans back out.

Small wonder that Mr Waigel has been rooting strongly for the project, while claiming to be keeping his options open. And it turns out that he has some powerful friends in the parliamentary group of the Christian Democratic Union, the senior coalition party led by Helmut Kohl, the chancellor. These allies argue that unilateral withdrawal from the project would harm Germany's credibility—especially now, when it is trumpeting on about the need for greater European integration. They also resent the way their party colleague, Mr Rühe, leaked his views in advance to the press, as they see it courting popularity and making it still harder for the government to stay with the project.

As so often in coalition squabbles, advocates on each side think they have the chancellor's support. In fact Mr Kohl seems not to have made up his mind, though he listened carefully to the pro-EFA arguments of his chum John Major in Bonn earlier this month. The government may agree to stay with the EFA, while demanding talks with its partners on cutting costs, maybe even on delaying production until the financial strains of German unity have eased.

Everyone agrees that a new fighter aircraft will be needed. The question is whether the EFA can be made to fit the bill. Britain, for one, is likely to be flexible to try to keep the Germans in.

Italy

Amo, amas, Amato

FROM OUR ROME CORRESPONDENT

OSCAR LUIGI SCALFARO, Italy's president, is a devout Catholic and a firm believer in miracles. He has been asked to perform one himself. It was Mr Scalfaro's allotted task to find a candidate among Italy's warring parties to lead the next government. His choice, after weeks of wrangling, has fallen on Giuliano Amato, the deputy leader of the Socialist Party. It was made at the request of the Socialist Party leader, Bettino Craxi, whose own hopes of securing the prime minister's job fell through last week.

The general election in April fatally

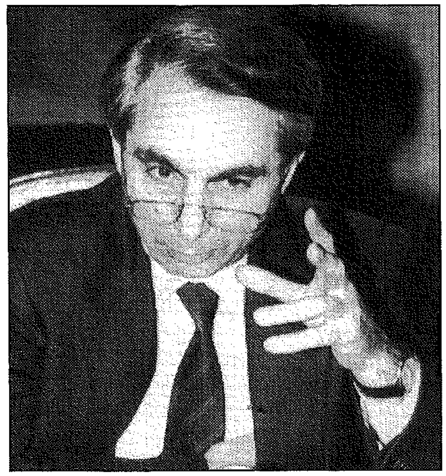
weakened the outgoing four-party coalition, but failed to throw up a clear alternative. Mr Scalfaro had to find a new prime minister who could count on the votes of the old coalition—an alliance of Christian Democrats and Socialists, supported by the tiny Liberal and Social Democratic Parties—in the hope that the appointee could also secure support of other parties for urgent economic measures and constitutional reform. Mr Amato, a professor of constitutional law, will have to search out common ground.

Leaders of the outgoing coalition admit that the tiny 16-seat majority which they still hold in the Chamber of Deputies, Italy's lower house, is insufficient to ensure stable government. It would be totally inadequate for a government wishing to push through difficult and unpopular measures, such as a pension-scheme reform to restrain Italy's galloping public deficit.

Mr Amato may find it easier to negotiate an agreement for some reforms with the Lombard League and its allies in northern Italy than with the Democratic Party of the Left, Italy's ex-Communists. Relations between the Socialists and ex-Communists have recently turned particularly frosty, as the two vie to lead the left.

Mr Amato also has the job of restoring public confidence in Italy's politicians. All the main parties have been shaken by a growing corruption scandal in Milan. Mr Amato had recently been despatched to take over the Socialists' Milan branch following damaging revelations and the arrest of prominent Socialists in April. More than 50 businessmen and politicians have been arrested in the wake of the Milan inquiry, and seven members of parliament have received notice they are under judicial investigation. These include an aide to the outgoing Christian Democratic prime minister, Giulio Andreotti, and two Socialist ex-mayors of Milan. It was Mr Craxi's close ties to Milan that probably scuppered his chances of getting the prime minister's job.

More arrests on corruption charges in other Italian cities, including Venice and Rome, have added to the sense of panic at party headquarters. The scandals, with almost daily revelations of kickbacks paid on public-works contracts, have dominated the headlines for weeks. The only politicians still smiling are those of the Lombard League and its sister parties, whose campaign against misgovernment by Rome won them 9% of the vote in April.


At last, it's Amato

Making politics more presentable will be just one of the new government's tasks. Most painful will be action to reduce the huge budget deficit—which threatens to overtake the combined deficits of Italy's European Community partners. At least Mr Amato, who was briefly treasury minister in 1987, understands the scale of the problem.

Skoupa-dooper profits

FROM OUR ATHENS CORRESPONDENT KAKAVIA

The third in our series of occasional pieces on borders turns to the goings-on at the main crossing between Greece and Albania

EURO BORDERS

GREEK customs officers reckon that most weekends the contents of a supermarket get lugged across the border at Kakavia, the main crossing point between Greece and Albania. The line of pick-up trucks hired by returning Albanians whose purchases cannot fit into a taxi sometimes stretches a kilometre down the road. Camouflage-clad Greek commandos lean against their sentry boxes watching Albanians shoulder televisions or sacks of food and head home.

Last winter the food sacks kept starvation at bay in southern Albanian villages, many of them so inaccessible that aid missions from Italy—Albania's other avuncular neighbour—could not reach them. Greek consumer goods were a source of start-up capital for Albanian entrepreneurs. About 100,000 colour televisions, refrigerators and washing machines were carried into Albania in 1991. Hundreds of second-hand cars and motorbikes were also brought over, plus spare parts for Albania's rapidly growing fleet of battered private vehicles.

On the Albanian side of the border, crowds of waiting relations press against a metal gate. The customs officers are too busy negotiating their own shipment of macaroni to take more than a cursory glance at what comes in. A 10% import tax is payable on large consumer items, provided the tax people can find them. By the time a television turns up in Tirana, it may have changed hands several times.

The official traffic is mostly one-way. Greek police buses regularly drop off a few hundred Albanians being deported under "Operation Skoupa", intended to get rid of undesirables. Lean young men in jeans and leather jackets leap out, waving good-bye to their escorts. "See you next month," says one named Adnan.

Adnan explains that, by turning himself in at an Athens police station, he saved the 5,000-drachma ($25) bus fare to the border. After selling a suitcaseful of cosmetics and underwear in the bazaar in Tirana—bought with money saved from working on a building site—he plans to come back to Greece. Not through the Kakavia crossing-point, but down a mountain track nearby.

The Greek commandos are supposed to discourage people like Adnan from entering Greece without visas. They patrol the mountains, but cannot block every path. Villagers on the Albanian side earn their living by showing would-be migrants where to slip across unnoticed.

During Albania's 46 years of Stalinist self-isolation, going abroad was forbidden under the constitution, except for official trips. Border guards were told to shoot fugitives on sight. There are many fewer guards now: their weapons are sold on the black market, often to Albanian rustlers who smuggle sheep across the border at night. Greek meat wholesalers are waiting to buy them at bargain prices.

About 100 Albanians cross the border legally every day. An ambulance service takes Albanians to Greek hospitals for operations: clinics in Albania cannot afford anaesthetics. But of the 130,000 migrants now in Greece about half are illegals.

Despite the deportations, the Greek authorities are not ill-disposed towards them. The Albanians are a useful source of cheap labour. Those from the ethnic Greek minority in southern Albania can find jobs fairly easily. Besides, a lot of Greeks were economic migrants themselves, before tourism and European Community membership made farming prosperous. The commandos at Kakavia are not expected to be overly vigilant.

BRITAIN THIS WEEK

Taking stock

Returning from the Earth summit, John Major sought to dispel doubts about the government's stance on the **Maastricht treaty.** He told the Commons that it was "good for Britain and good for Europe", and he rebuffed Tory Euro-sceptics by making clear that he wants Jacques Delors to continue as president of the European Commission.

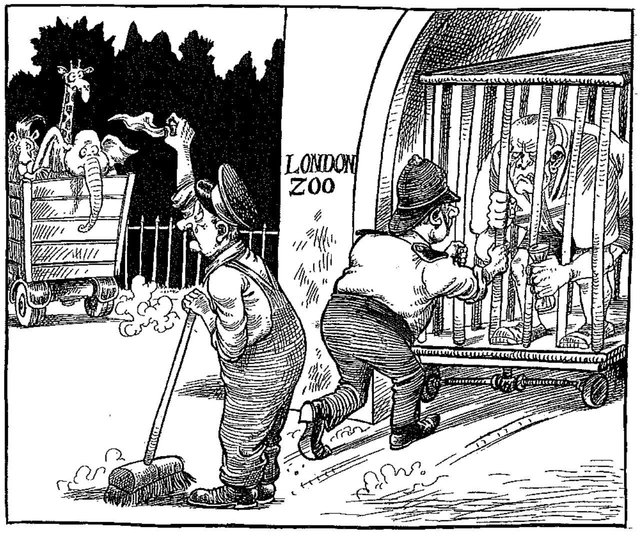
Neil Kinnock, nearing the end of his Labour Party leadership, withdrew from the contest for the future leadership of the EC's Confederation of Socialist Parties. Labour's increasing hostility to the Maastricht treaty posed a potential conflict of interests for Mr Kinnock.

Labour launched its official **election post mortem.** A report by Larry Whitty, the party's general secretary, blamed Labour's defeat on a failure to shake off its image as "a party of the past".

Mixed **economic news.** An extra 21,300 unemployed joined the dole queues in May, bringing the jobless total to 2.72m. Trade figures for the first quarter showed a surprisingly big current-account deficit, of £2.6 billion ($4.8 billion). But manufacturing output rose in April, for the third month in a row, even though retail sales were flat again in May. Meanwhile, government borrowing last month was a smaller-than-expected £3.1 billion.

Clearing the decks

More military cuts. Malcolm Rifkind, the defence secretary, announced that the navy is to scrap its stockpile of **seaborne nuclear weapons**—leaving nuclear deterrence increasingly in the hands of the Trident-submarine programme. George Bush and



Boris Yeltsin unveiled their arms-cutting plan the next day. A coincidence, said Mr Rifkind.

The government said the **National Economic Development Council**, set up in 1962 to promote more co-ordination on economic planning, is to fold. Businessmen cheered, Labour jeered and trade-union leaders wailed. Tory MPs were less sure: another coup for anti-corporatism, or harbinger of a fresh start by Michael Heseltine at trade and industry?

Football's officialdom watched aghast as **English hooligans** rampaged through the crowds attending the European championship in Sweden. The top official in European football, Lennart Johansson, warned that the violence might jeopardise England's plans to host the 1996 European championship finals.

The latest in a long line of threatened closures could be the last: staff at **London Zoo** were told that the world's oldest zoo will close in September, after 164 years in Regent's Park. The government withdrew its annual grant last year.

Moving on

With the all-party talks on **Northern Ireland** bogged down in their first stage, and restricted to local politicians, it was decided that "informal" discussions should begin on the agenda for the second stage, involving the politicians of the North and the government in Dublin.

IRA terrorists brought a Northern Ireland tactic to the mainland: **bombing-by-hijack.** Two gunmen forced a London mini-cab driver to take them round the West End, then abandoned the cab with a bomb in it. The driver escaped unharmed before the bomb exploded minutes later. Nobody was injured.

New disclosures threatened to lay some of the Maxwell pensioners' problems at the government's door. The *Financial Times* claimed that the intelligence services were eavesdropping on **Robert Maxwell** for years, and tipping off the Bank of England about his dishonesty. Not so, said the government.

The **privatised electricity companies** reported sizzling results: pre-tax profits at Norweb jumped by 96%, at National Power by 18%. The electricity regulator, Stephen Littlechild, had given warning that "excessive" profits would not be allowed. The companies' directors insisted theirs were fair.

The sporting life

A burly team of viscounts, earls and barons won victory for the House of Lords in their annual **tug-of-war** with the House of Commons—for the fifth consecutive year.

Royal Ascot, the horsey highlight of the year, opened with the usual **pedigree ogling**, on and off the track.

Three **Greenpeace** activists, disappointed at the outcome of the Earth summit in Rio, braved the pigeons and climbed Nelson's column in Trafalgar Square to hoist a protest banner from the top.

Winchester cathedral announced plans for its **choirboys** to sport new robes designed by a Japanese *couturier*, Issey Miyake. The Very Rev Trevor Beeson, dean of Winchester, assured his astonished congregation that "these long flowing things are quite the norm for us".

The Department of National Heritage, presided over by a sports-mad minister, David Mellor, accepted the Hambledon Cricket Club's 18th-century ledger from an unnamed donor in lieu of £39,120 ($72,763) due in **inheritance tax.**

University challenge

The masses are coming to higher education—and they are bringing the disciplines of the marketplace in their wake

TO JUDGE by the end-of-term rituals, academic life is much as it has always been. Students celebrate the end of their final examinations by getting uproariously drunk. Examiners prepare for weeks of deciphering illegible handwriting. Their more fortunate colleagues wonder whether to spend the next two or three months dawdling over an article or touring the continent.

Appearances are deceptive. The universities are destined to change more in the next five years than they have done in the previous half-century. The government is determined to treble the number of university students by the end of this decade. This pell-mell expansion will soon require the universities to rethink everything, from how they teach to where they get their income.

The expansion is already well under way. Five years ago, one in seven 18-19-year-olds went into higher education; today the figure is one in five. Within a year or so it will be one in four. In the past five years the number of students in universities has risen by 40%. The number in polytechnics has risen even faster.

Or rather, the number in what used to be called polytechnics. From next term the old "binary line" between universities and polytechnics will be removed: every polytechnic will be free to dignify itself with the title of university. At a stroke, this will increase the number of British universities from 51 to 85, and will double the number of university students to 566,000. At the next election, John Major will be able to boast that he has transformed university education from a privilege for the Brideshead set to a right for the Brixton crowd.

Allowing polytechnics to call themselves universities is not just a matter of changing their names—though names matter in the educational marketplace, as in any other. From April 1993 the universities and the polytechnics will compete for money on an equal basis, too. But anyone who expects unitary funding to produce a unitary higher education system is going to be in for a surprise.

Higher education will become much more diverse as well as much larger. The reason for this is a cunning change in finance. The old formula treated all academics equally. Potential Nobel prize winners and dutiful tutors were all paid to do research as well as teaching. The result was a system in which academics competed to produce the same product. All universities enjoyed long vacations (for research, naturally) and low student-to-staff ratios.

The education department has now started to disentangle salaries for teaching from money for research. The University Funding Council (UFC) plans to allocate most of its additional money for teaching to the institutions which pack in the most students. At the same time the UFC is increasingly awarding research money on the basis of departmental research-ratings rather than student numbers. And government research-councils (which are by their nature uninterested in teaching) are getting a bigger say in distributing the cash.

This means that universities will have to play to their strengths in competing for money. Prestigious universities will be able to resist expansion and make up their income from research grants. Their weaker rivals will have to concentrate on attracting more students and sharpening up their teaching. No wonder cynics say the binary line is not so much being removed as being redrawn at a higher level.

The result will be the rapid Americanisation of British higher education. At the top will be an Ivy League of ten research-minded universities, led by Oxford, Cambridge, the London School of Economics and Imperial College. Another ten or so universities will be able to preserve their current mix of teaching and research. But most other universities will become teaching-led institutions. Next year, for example, Brunel University will receive a 13.8% increase in funding for teaching but a 3% real fall in funding for research. And at the bottom of the system will be a mass of vocational universities, little interested in research but desperate to increase their "throughput" of students.

Read the questions carefully

Expansion is already pushing academia into rethinking some of its hallowed practices. Why cram teaching into three short terms? The American system of two-semester years (currently followed only at Stirling) makes for a more efficient use of resources. Why waste time putting on lectures? After all, in a sense they have been out of date since Caxton. Better use of video-tapes and computer-assisted learning could allow universities to pack in more students without losing the personal touch. And why should most students spend three years, neither more nor less, at university?

Potential Ivy League universities want to

emulate the LSE and shift their attention from cramming undergraduates to training post-graduates. Imperial College hopes to stretch its undergraduate degree in engineering from three years to four. Other institutions want to graduate students in just two years—or else (through something called modularisation) allow them to spend as long as it takes to amass enough credits for a degree.

Paying for the professors

The government insists that the rapid expansion of the universities can continue without quality plummeting or the Treasury revolting. The buzz-phrase in the education department is "efficiency gains". These there have certainly been. The expanded universities and polytechnics are actually awarding a higher proportion of first- and second-class degrees than they did five years ago.

And much more remains to be squeezed out of the system. Universities could reduce unit costs by merging with other institutions, and not just adjacent polytechnics. The merger of Manchester University and its nearby Institute of Science and Technology (UMIST), for example, could well produce the first British mega-university. Or else they could contract out some of their more basic teaching to cheaper further-education colleges—a practice already pioneered by some polytechnics.

But the universities are not just engaging in special pleading when they say that quality will soon begin to suffer. The student-staff ratio has risen from 9.3:1 in 1979-80 to 12.5:1 in 1991-92. Academic salaries are low: junior lecturers now have to scrape by on £12,860 ($23,840) a year, and professors seldom earn more than £35,000. The creation of teaching-led universities could make the job unattractive, into the bargain. Even the Ivy League will not be immune. Research income could soon be squeezed as the Treasury, confronted by the bill for increased student numbers, tries to make cuts elsewhere.

This points to the biggest question of all: how is the expansion of the universities going to be paid for? It cannot be ducked much longer. The case for financing universities out of general taxation was always hard to defend in theory: graduates are overwhelmingly drawn from the higher social classes and go on to earn higher-than-average incomes. It will soon become equally hard to preserve in practice. Some far-thinking dons favour moving to the Australian system (see box). Others favour full fees for the affluent and scholarships for the less well-off. Still others advocate top-up fees. The universities need to make up their minds on the issue, fast. If they dither, more higher education could well mean worse higher education.

What the heck, Bruce

HOW OTHERS DO IT

TWENTY YEARS ago it was Sweden. Today it is Australia and New Zealand. Pick up a tome on anything from paying for health care to dealing with traffic jams and Britons find themselves reading through wodges of stuff on The Antipodean Model.

Sweden's recent troubles provide a reminder that how-others-do-it panaceas should be taken with salt. But the Australian system of financing higher education (HECS to the in-crowd) does seem to have a lot to recommend it.

The basic idea of HECS, introduced in 1989, is to make the beneficiaries of higher education bear some of its costs. Students are obliged to pay an annual flat-rate contribution—A$1,993 ($1,550) last year—towards the cost of their education.

They can either pay over the counter, in which case they are eligible for a 15% discount, or else take out a loan, repayable through the tax system. Some students, such as trainee teachers and nurses, are given scholarships; others persuade future employers to pick up the bill; still others pay some of their fees over the counter and the rest through loans.

The vice-chancellors of Australia's universities report that HECS has gone down without a hiccup. There have been no campus riots, and the number of students is continuing to rise rapidly. The only complaint is that so many students choose to pay over the counter to take advantage of the 15% discount.

Unemployment

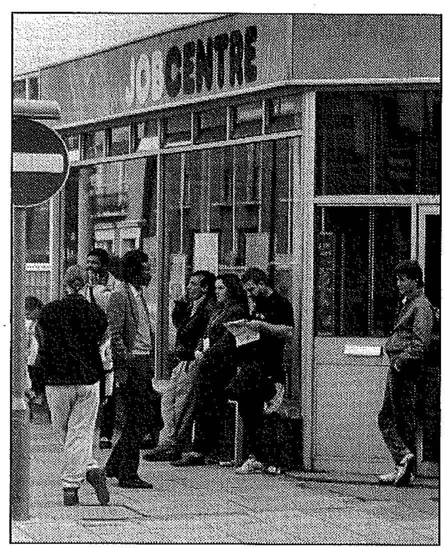
No end in sight

The jobless total rose again in May, for the 26th consecutive month. Behind the statistics is a social problem that seems as intractable as ever

THE official total for unemployment now stands at 2.72m. A leaked Whitehall document earlier this year suggested that the government fears it may remain above 2.5m for the rest of the decade. The human cost is evident, not least in the growing preponderance of the long-term unemployed: more than 53% of the unemployed have now been without a job for over six months and about 31% have not worked for more than a year. (The comparative figures a year ago were 44% and 25%.) And the financial cost to the taxpayer, if less emotive, is hardly less sobering: basic social-security payments to the unemployed will cost some £7.6 billion ($14.1 billion) this year.

Few people at Westminster retain much faith in remedies at a macroeconomic level. As the chancellor, Norman Lamont, underlined again in a speech to an audience of businessmen this week, economic policy remains firmly fixed on other goals—the fight against inflation, the need to sustain sterling within the exchange-rate mechanism—leaving unemployment to rise or fall as a consequence. But the corollary should be a more lively concern with the microeconomics of unemployment and the experience of those dealing with it every day.

Talk to the jobless in Tower Hamlets, a London borough covering a swathe of London's east end, where 20% of the workforce is unemployed, and one complaint is heard above all others: the jobs on offer in local job centres are not worth taking, because they do not pay enough. Anyone taking a job loses not only his dole money but also housing benefit, which automatically covers all



In with the out-crowd

his rent. Many prefer to remain unemployed, grabbing the occasional chance to earn extra cash in the black economy.

The poverty traps set by welfare-payment thresholds have been a concern for years, and the government has tried to lessen their impact. For example, those who take a low-wage job in place of the dole can now claim "family credit", if they have children to support. And the pre-election budget reduced the lower-rate tax-band from 25p to 20p in the pound for the first £2,000 of earnings. But few expect such measures to have much impact. Frank Field, a Labour MP whose views on the welfare state are widely respected at Westminster, has no doubt that something deeper than benefit traps is holding back many of the unemployed: the growing distance between them and the traditional work ethic. For many young people, in particular, unemployment is becoming a habit that is hard to kick.

Short of pushing benefits down below subsistence levels, how can the system be re-designed to drive the reluctant back to work? Mr Field would start by getting unemployed young men (in his experience, men are the worst offenders) to turn up at the job centre more regularly than once a fortnight—the current rule. More radical would be either (a) to introduce what Americans call "workfare" where, in some states, welfare payments are halted if claimants refuse a job offer; or (b) to limit the length of time an unemployed person can remain on welfare (presently unlimited).

But go back to the jobless in Tower Hamlets: they have other problems, too. Employers increasingly require work experience, even for the most menial of jobs. The government claims to have met this need with a new work-experience scheme, Employment Action; but it has only 61,000 places. Critics say it does not always offer useful experience: one Tower Hamlets man had been delivering meals to old ladies but was looking for a job in construction. Most fundamental of all, the unemployed are too often lacking in basic skills—not just to do a decent job, but even to apply for one.

Here the job centres could surely do more, if they had more resources. The average job adviser in Britain copes with five times as many cases in a week as his counterpart in Sweden; the unemployed, as a result, get little consistent and personalised help from the service. If John Major is serious about "empowering" those who are dependent on public services, as he claimed this week in a speech to the Adam Smith Institute, then the job centres would be as good a place to start as any.

Housing

Still waiting for a let-up

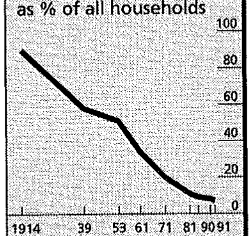
Despite a series of government initiatives and a flood of properties begging for tenants, there is little sign of a long-term revival in the rental market

WITH around 2m of the country's home-owners servicing debts more than their assets—according to a recent report by UBS Philips & Drew—it is hardly surprising that the economy is not bounding back to life. The collapse of the housing market helped pull the economy into recession, and property-related debt is now sitting heavily on the prospects for recovery.

It is not just the origins of this recession that prejudice most economists against the level of home ownership that now prevails in Britain. Too much ownership reduces mobility: people find it difficult to move to areas where jobs are being created. Companies that need to move people often find themselves having to buy their employees' houses—with uncomfortable consequences. Michael Tagg, national sales manager of Pricoa, a relocation agency, cites a company that recently approached him with 75 houses that it had had on its books for between one and two years. The cost, including finance, capital loss, fees and refurbishment, was around £4m ($7.4m).

If more people rented, fewer such problems would arise. But the rental market has been shrinking since the first world war: various laws have discouraged renting, while growing affluence and a readier access to borrowed money have cut back the obstacles to buying. Private rented accommodation is down to 7% of the housing stock, and still falling. Yet in France, the figure is 23%, in America 29% and in Germany 40%. Britain's rented housing caters only to marginal groups—the young, the poor, the just-divorced and the mobile. Elsewhere, all sorts of people choose to rent.

No vacancies
Private tenants, as % of all households



Source: Halifax Building Society

The government claims to understand the need to create more private rented housing. Yet it persists in pushing for more owner-occupation at the same time.

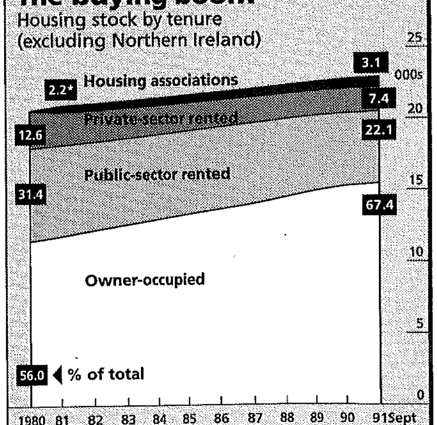
The list of incentives for renting is a long one. The 1988 Housing Act allowed landlords to set their own rents and restricted tenants' rights; for five years from 1988 the Business Expansion Scheme (BES) offered tax relief on income from investment in rented property; there is a programme attempting to bring flats over shops, which often remain empty, into the rental market; pilot projects are now testing a scheme to allow housing associations to act as managing agents for privately owned houses.

The stigma that stuck to landlords for so long after the 1960s, when rough and sometimes corrupt rentiers gave the business an unsavoury reputation, has disappeared. As a book to be published by the Joseph Rowntree Foundation on June 23rd shows, even the Labour Party has abandoned its prejudice against landlords as vile extortionists, and now sees them as a group to be encouraged. This matters: though the election of a Labour government currently seems only the remotest possibility, institutions investing in property have to look to the distant future.

So is the rental market at last taking off again? At first glance, it might appear so. The classified pages of any local paper these days are stuffed with properties to rent. Yet most belong to people who bought and could not sell, or developers who built and could not sell. When (if?) sales pick up, the properties will be got rid of. Aside from a few companies that have been started up in recent years to take advantage of the BES tax break—and one non-BES company, Quality Street, now owns around 2,000 properties for letting—there is little sign of fresh money moving into the rental market.

The economics of renting is not encouraging. According to figures produced by Peter Kemp of York University and Tony Crook of Sheffield University, average net returns from renting property under the BES scheme were 4.6%—just worthwhile with tax

The buying boom
Housing stock by tenure (excluding Northern Ireland)



Source: Department of Environment *1981

Across five continents, impressions of the Singapore Girl. 20

relief, but not without.

Returns from renting are low partly because the tax system, by making buying so attractive, reduces demand. Tax relief on mortgage interest is worth about £900 ($1,670) a year, and is increasingly important as house prices drop. Before the abolition of Schedule-A tax, 30 years ago, the bias was less obvious: people who owned their houses were taxed on the imputed income, in the same way as people who chose to rent and keep their capital in the bank were taxed on the income from their cash.

Even with the mortgage subsidy, a tenant's outgoings are likely to be less than those of an owner-occupier. Somebody with a 100% mortgage on a £100,000 house would, at the moment, pay £11,000 a year, whereas a similar property would let for £6,500-9,000, depending on where it was. But capital gains are probably more important in the minds of prospective buyers. Capital gains on a principal residence, unlike on any other big asset, are tax-free. It may be that the capital losses so many have recently suffered will change attitudes; but looking 20 years ahead, most people still believe that house prices will rise at least as fast as retail prices.

From the investor's point of view, too, the tax system makes rental housing a less attractive prospect than most businesses. Renting does not benefit from the capital reliefs on investment allowed on industrial buildings and goods, nor does it benefit from the provision that allows trading companies to offset losses in some parts of an enterprise against profits in another.

The Business Expansion Scheme, which brought 16,000 properties into the rental market, is due to be wound up next year. With tax relief no longer available on income from BES properties, most people in the housing world expect to see them up for sale. The rental market will then shrink further.

Housing lobbyists on both left and right are arguing for an extension of the BES, or else a substitute for it. They are not optimistic. Sir George Young, the minister for housing, spends most of his time worrying about the public sector, and is said not to be much interested in the matter of private rentals.

A less nuclear navy

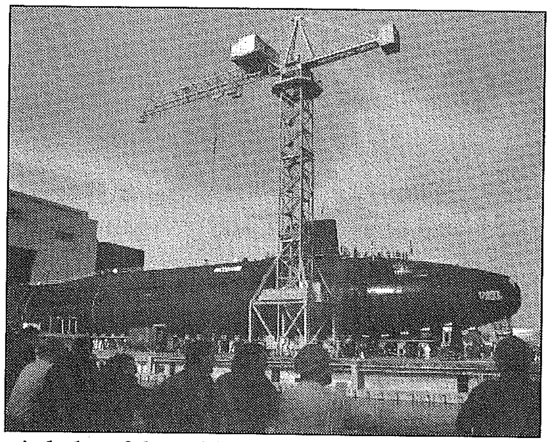
THE Ministry of Defence followed the Pentagon's lead last year in announcing that, "under normal circumstances", Royal Navy ships would no longer carry tactical nuclear weapons. But this implied the weapons could be brought back pretty smartish if need be. Now a new defence secretary, Malcolm Rifkind, has said the navy is to abandon the weapons completely—ending the deployment of nuclear depth-charges on the RAF's Nimrod anti-submarine patrol aircraft, as well as the use of nuclear bombs by Sea Harrier aircraft and nuclear depth-charges by carrier-borne helicopters.

The new ruling is a big step forward on last year's. The safety, security and training requirements for dealing with nuclear weapons are expensive and time-consuming; most navy men and Nimrod squadrons will be delighted to be rid of them. By the same token, once the hardware and training systems fall into disuse, it would take a great effort to put the weapons back into the aircraft and helicopters that are equipped with the special wiring to launch them.

Even assuming, that is, that the weapons remained in storage. In fact, those belonging to the Ministry of Defence are to be destroyed. The depth-charges for the Nimrods, which are American weapons stored in Britain, are to be sent back to America.

The strategic risk involved in decommissioning the weapons is probably slight, at worst. The biggest uncertainty, such as it is, relates to getting rid of the nuclear depth-charges. Their main purpose was to attack heavy-hulled deep-diving submarines, and the Russian navy still has some of these. The torpedoes used by surface ships and aircraft have trouble going fast enough to catch modern Russian submarines at great depths, and they are not really built to carry the large warheads needed to get through the titanium used in the Russian submarines' hulls. Without nuclear depth-charges, the job will have to be left to larger, conventionally tipped torpedoes fired by submarines.

Once the navy's tactical weapons go, the only nuclear weapons that Britain will retain—short of its strategic Polaris missiles—will be a handful of WE-177 gravity bombs. These will be kept for use by the RAF's fighter-bombers, as part of a commitment to NATO that some short-of-strategic weapons will stay in service as a last reserve. There is a lobby arguing for the replacement of the WE-177 by a "stand-off" missile, which would allow bombers to attack heavily defended targets without having to fly over them. But this would be an expensive project. There is plenty of controversy even within the defence ministry over whether to press for it, given the present tide in favour of scrapping the cold war's legacy and cutting back on defence spending in ways that were inconceivable a few years ago.



Big baby of the cold war

The latest announcement to this effect, the Russian-American agreement to make deeper cuts in the two countries' strategic arsenals than already agreed (see page 24), came a couple of days after Mr Rifkind's statement on June 15th, and rather upstaged it. Far from winning applause for a bold initiative, his curtailment of the navy's nuclear role may just have helped draw attention to the bigger question that now hangs over Britain's use of nuclear weapons: what, if anything, should be done about the Polaris-replacing Trident programme that is scheduled to produce four submarines, each able to carry 128 nuclear warheads in 16 missiles? If the cold war is really over, does Britain need that many warheads—and does it need Trident at all?

From the beginning of the Trident programme, the Ministry of Defence has made clear that 128 warheads per submarine is the theoretical maximum, not the number that it would necessarily deploy—it is possible to deploy fewer warheads per missile or fewer than 16 missiles per submarine. Britain's nuclear establishments have already been having trouble producing the Trident warheads, which is one good reason for expecting a lower deployment when the submarine enters service around the middle of the decade. The big cuts now being planned by the Russians and the Americans will provide a further pretext for scaling back Trident's armaments. But will fewer warheads appease those who see the changing international climate as a reason to scrap the submarine altogether?

The Tories' Free Europe

START with a blank sheet of paper. What sort of Europe does the Conservative Party want? Few Tory MPs are either fanatical federalists or fanatical nationalists. But the moderate middle has lacked a clear vision of the Europe it would like to end up with. Because of the pressures on them, John Major and his ministers have preferred to keep things complicated, and have crouched in a swirling mist of Euro-babble. But clarity is becoming essential.

Without a clear and simple vision, there can be no popular consent in the country—jargon and obscurity have ever been the enemies of democracy. Nor can there be any strong sense of political purpose at Westminster. There, the argument has been left to the fanatics.

Now, at last, a vision of Tory Europe is starting to emerge. It is a starker, less compromising version of what Mr Major was arguing for at Maastricht—probably too stark to be fully realised. Even so, it needs to be aired, if only because it commands assent across a swathe of Tory MPs, including cabinet ministers.

In essence, the vision would require Britain to accept more centralism—more majority voting and more regular legal intervention from the European Court of Justice—but only across a relatively narrow band of policy. That band would include the removal of any remaining barriers to free trade, and measures to curb cross-border pollution. Under and alongside this single, plain structure, other policies would be dealt with between those states that wanted to co-operate. Most would do so on defence, but neutral Ireland and Austria could stay out. Many would co-operate on the removal of immigration checks; Britain would not. In the horrible jargon, this pick-and-choose aspect of Europe is called "variable geometry", though Bagehot prefers the ECA, or Europe of Consenting Adults.

At Maastricht, the bits kept outside the existing Community were confined to new kinds of European union—defence, police co-operation and immigration. Tory Europe, by contrast, would see the federalist Community shorn of some existing functions and kept away from big new ones, like monetary union. At Maastricht, the rights of nations were vaguely defined through the doctrine of subsidiarity: but this means different things to different people. A cross-section of Tory MPs would prefer instead a legally binding "states' rights" clause to create a clear and legal frontier between federal functions and the rest.

These three aspects—narrow but deep centralism, the ECA and states' rights—are compatible with what Mr Major fought for at Maastricht, but go much further. Since the manufacture of neologisms is such an important European growth industry, perhaps Tories should simply call this "Free Europe". This is a rather cheap, propagandistic phrase; but then so is "European Community". And, like that, it would translate well.

The next foreign secretary?

Free Europe is no panacea: it would anger continental politicians, including German ones (see page 48) and would raise as many problems for Britain as it solved. It would mean the last ultra-patriots in the Tory party swallowing a tough, majority-voting regime that was clearly superior to the Commons on some important issues. A single currency would have to be agreed outside the central structure, because of the political dimension many of its supporters think it needs; so Britain would have another hard "in or out?" choice. The European Parliament would be left in an awkward limbo: should it develop as a full-scale legislative and auditing machine to deal with a few issues only; or should it relapse into a grand talking-shop? Influential cabinet ministers would like to see it shrivel.

But Free Europe would have real attractions for the Tories. Most importantly, it offers a way of ending Europe-as-process, and establishing an armistice between federalists and nationalists. This has to happen sooner or later anyway. Second, it would logically divide those aspects of politics which follow the multinational world of modern business from those bits which most national governments think they should hang on to. Third, it would allow a relatively quick and ambitious enlargement of EC membership without destroying the efficiency of the federal part of Free Europe. And if it led to a full European union, then this would happen slowly, raggedly and even, perhaps, with the consent of all those involved.

This vision attracts moderate Euro-enthusiasts who see Douglas Hurd, the foreign secretary, as the country's greatest pragmatic politician. But it also attracts those who call themselves Euro-sceptics, and who would like Norman Lamont, the chancellor, to take over from Mr Hurd when (as Mr Hurd's friends predict) he decides to retire in two or three years' time. Mr Hurd and Mr Lamont, despite their political differences, are closer on day-to-day European matters than their cheer-groups realise. How, though, does all this fit into Mr Major's agenda?

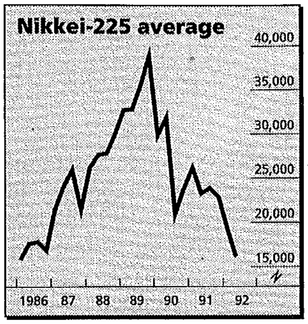
He is committed to trying to save the Maastricht treaty because to do anything less would be to destroy his precious credibility with other EC leaders. So he is running a twin-track strategy. The diplomatic strategy is aimed at the Danes and involves a real attempt to rescue the treaty, despite the distaste that much of his party feels for it. But the preservation of Maastricht is not, ultimately, in Mr Major's hands. If he fails, senior ministers expect him to express regret and try to rescue its inter-governmental parts from the debris. The political strategy is to keep any confrontation away from the Commons until the diplomatic position is clear; and then to twist arms and cajole his party.

Though risky, the strategy is coherent just so long as Maastricht survives. But what if it fails? That is the question bright Tories are grappling with. The twin-track approach then might be to rally the Tory party behind Free Europe, or some variant of it, and spend the next few years lobbying across the continent.

The Community's next inter-governmental conference was planned (at Maastricht) for 1996. By then many of the ardent federalist leaders will have retired and it will be clearer how far their voters really want to go towards outright union. Perhaps "Free Europe" will prove just another wraith in the Channel, and Britain's choice will be to accept full federalism—or leave. In the meantime, though, Free Europe offers a coherent post-Maastricht strategy. Mr Major knows he must be able to chart a way forward for the Tory conference this October. He cannot play things too long.

BUSINESS THIS WEEK

Fire and water



Pessimism over **Japan's economy** drove the Nikkei average down to just above 16,000, its lowest closing level for six years. The plunge came a few days after a central bank quarterly report showed business confidence in Japan at a five-year low.

America's Justice Department suspects that **collusion in the Treasuries market** may have been much wider than at first thought. Its investigation, prompted by the Salomon Brothers scandal, is now described as "industry-wide". It will look for "pre-auction conversations" among dealers that may have broken anti-trust laws.

Ian and Kevin Maxwell, sons of dead fraudster Robert, were arrested in the early morning of June 18th by London police working with the Serious Fraud Office. Both were charged with conspiracy to defraud; Kevin Maxwell was charged with theft. Their homes and offices were searched for information relating to the disappearance of Maxwell companies' pension assets.

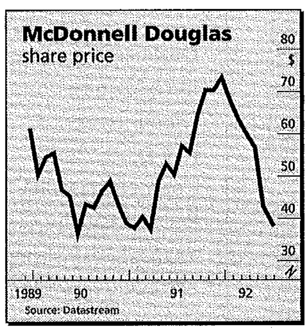
Werner Keicher, head of the secretive **Maxwell Foundation** in Liechtenstein, announced that its coffers were bare. The trust, he said, has no cash either licit or illicit. What income it has goes to charity, not to the Maxwell family.

Lloyd's, London's insurance market, gave up efforts to rescue loss-making members (names). They will now sue Lloyd's instead.

Alan Greenspan, chairman of the Federal Reserve, supported the idea of indexing some American **government bonds** for inflation. He said such an arrangement would be useful to the Fed's policymakers. It is an idea the Treasury has previously rejected.

The proposal by the Abu Dhabi government, major shareholder in **BCCI**, to pay the defunct bank's depositors and creditors 30 cents on the dollar was approved by a British high court, though not by most depositors.

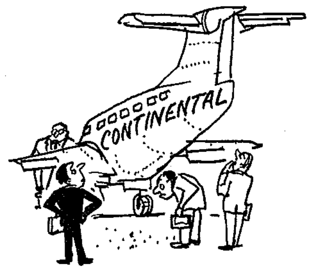
Air currents



A lack of orders for its MD-12 jumbo jet means that **McDonnell Douglas**, a big American aerospace group and rival of Boeing, will almost certainly abandon the end-year launch of the aircraft on which it had pinned its financial hopes.

To keep up with **satellite competition**, the aerospace subsidiary of Daimler-Benz, Dasa, joined three other European space companies, France's Alcatel and Aerospatiale, and Italy's Alenia, in taking a 12¼% stake in Space Systems/Loral, an American maker of commercial satellites. Dasa will pay $57m for the stake.

Two big airlines, Germany's Lufthansa and Japan Airlines, are upping their stakes in **DHL International**, the world's biggest air courier, from 5% to 25% each. Nissho Iwai, a Japanese trading house, will take its stake from 2.5% to 7.5%. The three holdings represent an investment of around $500m.



Four investors were said to be interested in America's **Continental Airlines**, in chapter 11 protection from creditors for the past 18 months: British Airways, Air Canada, Fort Worth's Bass family and a Houston financier, Charles Hurwitz.

The planned flotation of **GPA**, an aircraft-leasing company, was abandoned just hours before it was due. The company blamed weak stockmarkets.

J'ecus

The **Bank for International Settlements**, the central bankers' bank, criticised the Maastricht treaty on European economic and monetary union for leaving key issues undecided. It said the goal of price stability could be hindered by lack of political consensus.

Philips, Grundig and other European firms have complained to the European Commission that Japanese producers are **dumping** CD players throughout Europe. The allegations were repudiated.

A European commissioner, Sir Leon Brittan, warned banks they must cut their fees for **cash transfers** between EC countries or face legislation to make them become more efficient. At present bank charges on 200m cross-border transfers cost customers 2 billion ecus ($2.6 billion) each year.

A group of 38 companies, broadcasters and programmers will receive as much as 850m ecus ($1.1 billion) from the European Community to help them prepare for **high-definition television.**

Plugged out

Canadian telecoms regulators ended Bell Canada's monopoly on the carriage of long-distance telephone calls. Rogers Communications, Canada's biggest cable operator, and Canadian Pacific, a railway company, will be the first new competitors.

After two years of trying, **British Telecom** sold its stake in Mitel, a loss-making Canadian telecoms switchboard manufacturer, to a group of nine unidentified investment partnerships—at a loss of over C$250m ($210m).

IBM, which has heretofore kept all of its semiconductor production strictly for its own use, said it this year hoped to sell $500m-worth of chips on open markets.

America's House of Representatives voted to halt construction of the world's most expensive physics experiment: the $8.3 billion **super-collider** being built in Texas.

VIEWPOINT

The Commerzbank report on German business and finance 6/92

Germany as a business location: facing new challenges

Germany's appeal as a business location has become a hotly debated issue again, with the country's economic slowdown and difficult pay negotiations adding to the prevailing scepticism as to its international competitiveness.

For one thing, unification means that several million economically viable jobs will have to be created in eastern Germany, making it imperative to improve its attractiveness as a production site. For another, Central and Eastern Europe are emerging as low-wage competitors, posing a threat to the jobs of Germany's less skilled workers in particular. Last but not least, the completion and enlargement of the Single European Market will increase the mobility of capital, which will boost direct investments in promising locations.

The decisive factors

The attractiveness of a country as a location is determined by a number of factors. Some are structural, such as the availability of raw materials, short distances to customers, communications, the qualifications of the workforce, the legal framework and political stability. Others, such as wages, taxation and government regulations, are more open to political influence.

International comparisons frequently highlight individual factors, usually wage costs and taxes. Western Germany's labour costs are among the highest in the world, even after allowance for its high level of productivity. And this problem has been aggravated by recent hefty pay increases. Moreover, Germany's corporate taxes are very high and its environmental standards are quite tough.

> **"The present debate may be useful in achieving greater flexibility."**

At the same time, though, the country offers substantial advantages. These include its highly qualified workforce, smoothly functioning banking system and efficient capital market. In addition, western Germany's infrastructure is very good, the country is politically stable and its economic policies are geared to maintaining monetary stability. Moreover, its attractiveness as a business location has been enhanced by the end of the Cold War. The domestic market for German companies has expanded considerably; economically speaking, Germany is now at the heart of Europe.

Occasionally, its lopsided direct investment balance is cited as evidence of its waning attractiveness. Over the past three years, its companies have invested DM 97 billion abroad, while the flow of funds in the other direction has amounted to only DM 19 billion. Yet for a capital-rich country, this is no cause for concern; in fact, over the same period, domestic business investment totalled DM 960 billion.

At least as far as technologically sophisticated goods are concerned, competition in the world's markets focuses on innovative products and intelligent production methods. With regard to R & D spending, German firms are among the leaders internationally, devoting a fifth of such outlays to basic research – considerably more than their competitors. What needs to be improved, though, is the commercial application of new products and manufacturing techniques.

The new challenges facing Germany make flexible responses essential: in the overly regulated labour market; in public finance, where the reduction of subsidies and state spending should help keep deficits under control and cut corporate taxation; and, generally, in terms of eliminating unnecessary regulations. Although the present debate tends to exaggerate the problem, it may be useful in achieving greater flexibility and in mobilising public support for much-needed structural changes. Given the right signals from the Government and moderate pay settlements, Germany has a good chance of maintaining its current high income levels without seriously jeopardising job creation.

Western Germany's strengths and weaknesses

	fairly strong	fairly weak
Qualifications of workforce	●	
Infrastructure	●	
Labour costs		●
R & D	●	
Corporate taxation		●
Political stability	●	
Energy and environmental costs		●
Flexibility of working hours		●

COMMERZBANK
German know-how in global finance

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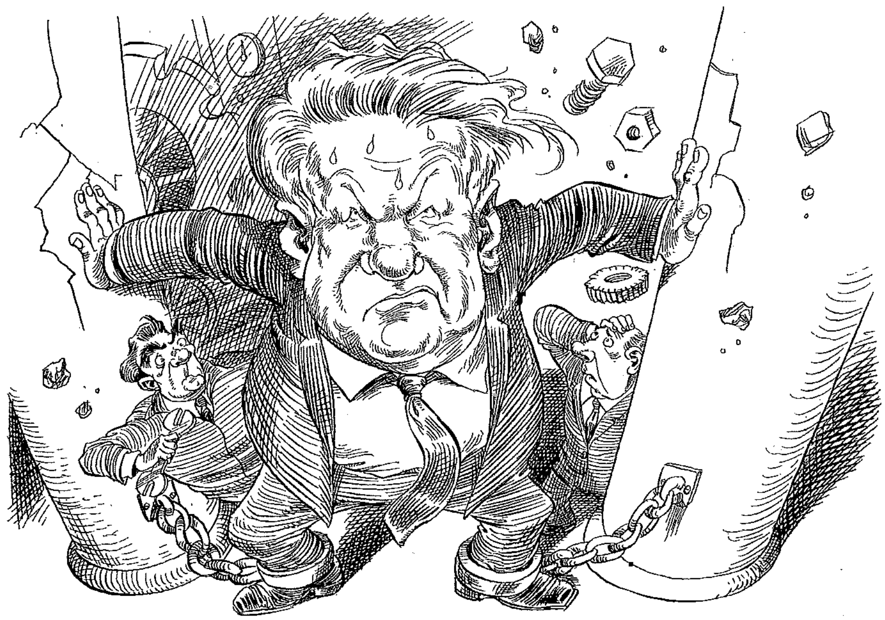


Yeltsin agonistes

MOSCOW

Boris Yeltsin is struggling to tear down the monolith of Russia's state-owned industry in order to make way for the market economy. To do this, he needs the help of Russia's industrial managers. But they are determined to slow the pace of reform

AFTER six months of economic "shock-therapy", Russia's industrial managers have found their political voice. Alarmed at the speed and direction of the Russian government's economic reforms under President Boris Yeltsin, Russia's industrial managers are demanding a greater say in how the country is run.

So far Mr Yeltsin has bravely backed the group of radical young reformers around Yegor Gaidar, whom he appointed prime minister on June 15th. He would prefer to brush the objections of the country's managers aside. After all, most of them got their jobs from the Communist Party. They are the elite of the dying system that Mr Yeltsin is trying to replace. Unfortunately, because these managers still run most of the country's factories, he cannot afford to ignore them. Instead he is trying to appease them. He has appointed three new ministers from the managers' ranks, even while pushing forward with plans to dismantle state-owned industry through privatisation and other market-based reforms.

The most influential new minister is Vladimir Shumeiko, one of a group of new deputy prime ministers. A former factory manager in southern Russia and deputy chairman of Russia's fractious parliament, he is the chairman of the Confederation of Unions of Entrepreneurs of Russia, the smaller of the two main groups representing Russia's state-industry bosses. Another new deputy premier is Georgy Khizha, the former director of a defence factory in St Petersburg. Together the two men will run Russia's giant industry ministry. The third member of the troika, Viktor Chernomyrdin, is a former minister for the gas industry who opposes the freeing of energy prices, one of the key reforms pushed by Mr Gaidar and his team.

Behind these three men stands an even more formidable figure, Arkady Volsky, who heads the Union of Industrialists and Entrepreneurs of Russia, which represents managers in factories that produce two-thirds of Russia's industrial output. Despite the word "entrepreneur" in their organisations' titles, none of these men represents the thousands of genuine Russian entrepreneurs who have started businesses in the past six months. They are leaders of the old guard, the bosses of giant state enterprises, especially defence plants.

Mr Volsky, a 60-year-old engineer, exemplifies the industrial elite which owed its status to the Communist Party and which has survived its demise. Once the party's commissar at the giant Likhachev car works in Moscow, which produces the Zil limousine, he went on to become economic adviser to three general secretaries (Andropov, Chernenko and, briefly, Mikhail Gorbachev) before being banished to the impossible job of running Nagorno Karabakh, the disputed Armenian enclave in Azerbaijan. After returning to Moscow, he assumed his present post and is now one of the most powerful men in Russia.

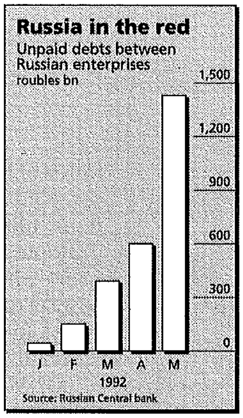
The industrial bosses whom Mr Volsky represents have always been influential in Russia. But in the past they exercised their clout during negotiations over the government's five-year plans. Now they are using Russia's more open political system to get their views across. Many of Russia's parliamentary deputies, elected in 1990 when the Communist Party still controlled appointments at most factories, are managers of state enterprises. To get economic-reform measures through parliament, Mr Yeltsin has to win support from at least some of these.

Russia's managers have also joined forces with workers to slow the pace of reform. With the economy in turmoil, both managers and workers at state-owned enterprises feel threatened by the prospect of still more change. Mr Volsky's organisation has links with the Union of Work Collectives, a trade union, and the two groups have founded their own party, called Renewal. When Mr Volsky talks—or, more accurately, threatens—Mr Yeltsin has to listen.

What state-industry bosses want is more government credit (ie, subsidy) and the delay of some reforms. It is easy to see why they are alarmed. Industrial output is now around 15% lower than it was in the middle of 1991. Within this total, metal-making is 22% down and output in industries that build machines for defence and agriculture (two areas where Mr Volsky's support is strongest) has fallen by even more. These declines come on top of similarly large drops in production last year. Output would have fallen even faster if companies had not kept business going by extending enormous

amounts of credit to each other (see chart).

Mr Volsky argues that the fall in output is reaching a point from which no economy has ever recovered. To stave off collapse, he says, the government should switch to a "managed transition to the market". By that he means heavy subsidies for enterprises; a rise in the price of oil to world levels over three years, rather than a sudden freeing of prices as proposed by the reformers; and limits on foreign borrowing.



Some of these demands have been met. The government has promised an extra 200 billion roubles ($2.4 billion) of cheap credit for industry, plus 120 billion roubles for the oil business. And it has postponed the freeing of energy prices, originally planned for April, by up to a year.

The government's concessions to the industrial managers have led to a confrontation with the International Monetary Fund (IMF), which is now trying to decide whether the $24 billion in aid which Russia has desperately sought can begin to be disbursed. The failure to free oil prices this year breaches a "memorandum of understanding" signed with the IMF in February.

Though the Fund is right to be worried, Mr Yeltsin's government has not abandoned reform, just slid a few steps back. The 320 billion of extra subsidies it has agreed to give state industries will raise government spending by roughly 5% of GNP. This will double the government's expected deficit for the second quarter of this year and is, by the standards of most countries, a suicidally large sum. But it is a far cry from what was demanded by industrialists in April. Mr Gaidar calculates that their claims would have added 1.2 trillion roubles to spending, bringing the government deficit to 23% of GNP. Instead, the deficit was 1.5% in the first quarter and is now likely to be 10% in the second. Such figures may be tolerable for a while, especially as other reforms are going ahead. Its privatisation scheme has cleared the first parliamentary hurdle. (Anatoly Chubais, the reformist privatisation minister, has been promoted; he becomes yet another deputy prime minister.) And the rouble will be floated on July 1st.

Whenever parliament has tried to block key reforms, Mr Yeltsin has acted with dispatch. After parliament had refused to pass a bankruptcy law, he issued one of his own by presidential decree, just before boarding the aeroplane to his summit meeting with Mr Bush this week. Under the decree, enterprises that cannot resume service of their debts within three months will be declared bankrupt and sold by auction. If Mr Yeltsin carries that through, no amount of subsidy is going to help Russia's recalcitrant state-industry bosses for much longer.

What recession?

POLITICIANS, economists, businessmen and journalists have fretted for the past two years about the world recession. And yet, by some definitions, there has been no recession, at least in the world's seven biggest industrial economies taken as a whole. Their average GDP has continued to rise in all but one quarter, which means they have escaped recession by America's definition, which is two consecutive quarters of falling output. By another definition, namely a year-on-year fall in GDP, the recession also remains a myth. The 12-month growth rate has stayed positive throughout, unlike in the two previous (and genuine) recessions (see chart). True, the 12-month growth rate slipped to only 0.6% in mid-1991, but on the basis of the five countries that have published figures for the first quarter of 1992, the growth rate has since picked up to 1.5%.

Behind these figures lies the fact that the G7's cycles have become desynchronised. When America and Britain dived into recession in 1990, Germany and Japan kept booming. As Germany and Japan slowed in 1991, growth in America and France perked up.

Privatisation in Eastern Germany

Otherwise engaged

BERLIN

SMALL and medium-sized companies, collectively known as the Mittelstand, are the engine of western Germany's economy. No wonder, then, that many Germans are keen to create another version of this dynamo in the former East Germany. To further this goal, the Treuhandanstalt, the body charged with privatising state companies in eastern Germany, is holding a conference in Berlin on June 20th to find ways to speed up the privatisation of small firms in the East. And yet, despite its declared enthusiasm for small firms, the Treuhand's own bureaucracy has been the biggest stumbling block for west German entrepreneurs trying to win control of the many small enterprises still on its books.

The Treuhand has already been attacked for doing too little to promote small business and concentrating instead on the sale of big firms. Wolfgang Kartte, the head of Germany's cartel office, has complained twice since April that the Treuhand was failing to create a Mittelstand in the east.

Stung by this criticism, Birgit Breuel, the boss of the Treuhand, wrote to Mr Kartte pointing out that the Treuhand had arranged more than 1,200 management buyouts in eastern Germany and claiming that it is keen to attract entrepreneurs from western Germany. In August the Treuhand plans to change some of the rules requiring competitive bids, which are more appropriate to big firms, in order to ease the sale of many of the 4,800 companies which it has left in its portfolio (see chart on next page). Most of these are of Mittelstand size.

Lower down the Treuhand's vast bureaucracy, however, there seems little interest in dealing with western Germany's small businessmen. A Treuhand advertising campaign this year, aimed at attracting western

Don't blame Birgit

A few home truths

Stock and bond markets in different countries may be dancing more closely in step with one another, but house prices continue to go their different ways

BUYING a house is the biggest investment most people ever make. It is hardly suprising, then, that changes in house prices have a big impact on the rest of an economy. The rapid increases in house prices in the late 1980s signalled that economies such as Britain's and Australia's were overheating. Big rises in the value of their houses made many consumers feel wealthier, which in turn encouraged them to go on a spending spree. Recent falls in house prices have had just the opposite effect, making consumers feel poorer and so cutting their spending.

Despite the importance of house prices, few governments bother to collect much information on them; most national figures come from estate agents and mortgage lenders. This makes international comparisons tricky. Every year, however, in its annual report, the Bank for International Settlements, the club of the world's central bankers, pulls together these figures in a handy summary.

The first chart looks at long-term trends. Real house prices (ie, adjusted for overall price inflation) have risen since 1980 in all the cities shown except Copenhagen, where they plunged by an average of 6% a year between 1980 and 1991.

Tokyo's property boom in the late 1980s, when house prices more than doubled in two years, puts it at the top of the international league. But Tokyo also suffered the biggest price collapse last year. The next-largest gains since 1980 have not (contrary to what many believe) been in the English-speaking countries, where people seem to talk of little else but buying or selling their houses. Paris and Madrid saw bigger gains. There, real house prices rose by an annual average of 6-7%.

In English-speaking countries the house-price boom has turned to bust. Real house prices have fallen by a quarter to a third from their 1980s peaks in London, New York, Sydney and Toronto. During earlier downturns in these housing markets, high inflation allowed real prices to adjust without requiring much, if any, fall in nominal house prices. But this time, with lower inflation, nominal prices have also fallen sharply. A drop in prices, combined with high levels of mortgage borrowing in America and Britain, means that some people's mortgages now exceed the value of their homes. Prices have started to recover in Sydney and New York, but in London they continue to slide.

ECONOMICS FOCUS

Differences within national housing markets are often as big as the differences between them. For example, since the end of 1988 average house prices in the south-east of England have tumbled by 24%; in the north of the country they have risen by 41%. In 1987-91 average prices in New York fell by about 10%; in Los Angeles they jumped by 50%.

The experience of the past 11 years clearly casts doubt on the popular argument that the monetary discipline imposed by Britain's membership of Europe's exchange-rate mechanism (ERM) will restrain real house prices in Britain over the coming years. House prices in long-time ERM countries, such as France and Germany, have actually outpaced those in London in real terms since 1980. Although house prices in London have recently tumbled, those in Frankfurt and Paris have seen big gains.

In Madrid property prices have more than tripled in the past five years; in Paris they have more than doubled. And Frankfurt saw a 44% price rise in 1990 and 1991, as an influx of workers from eastern Germany boosted the demand for housing. During the previous decade, in contrast, when Germany's population was shrinking, real house prices fell in more years than they rose.

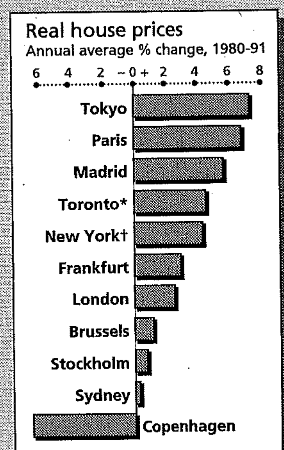
A single European market in housing is a long way off. There are huge differences in the level of house prices, cultural attitudes, housing finance and tax systems. The rate of home ownership, for example, varies from 40% in western Germany to 82% in Ireland. The average price of a house in Germany is more than twice that in Britain.

In continental Europe tax regimes tend to favour housing less than in Britain, let alone America. In Britain capital gains on one's main residence are tax free, but gains are taxed if the property is sold within two years in Germany and within five years in France.

Tax relief on interest payments has become less generous almost everywhere over the past decade. Some countries have restricted the amount of relief, while lower marginal rates of income tax have trimmed the value of that relief. For example, when Britain's top rate of tax was 83%, the net interest cost on a 10% mortgage rate for a top-rate taxpayer was only 1.7%; today, with relief limited to 25%, the net cost is 7.5%.

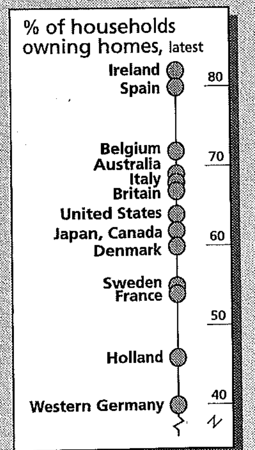
Financial liberalisation in Britain and other English-speaking countries went further and faster than in continental Europe in the 1980s, allowing home buyers to borrow a higher multiple of their incomes and a larger amount in relation to the value of a property. Until recently it was possible to borrow 100% of the value of a house in Britain and 95% in America. In Germany and France deposits of 20-40% are usually required.

Mortgage debt in France and Germany as a percentage of GDP is therefore less than half that in Britain and America. This leaves plenty of room for more borrowing as European housing finance is liberalised. If so, continental Europe's house-price boom might still have further to run.



Nominal house prices
Annual changes, %

	1990	1991
Frankfurt	20	20
Madrid	20	9
Sydney	−10	8
Paris	18	6
Stockholm	11	3
Copenhagen	−8	2
Brussels	22	0
New York	−5	−1
Toronto	−15	−4
London	−7	−5
Tokyo	7	−9



Sources: BIS; US National Association of Realtors; UK Council of Mortgage Lenders

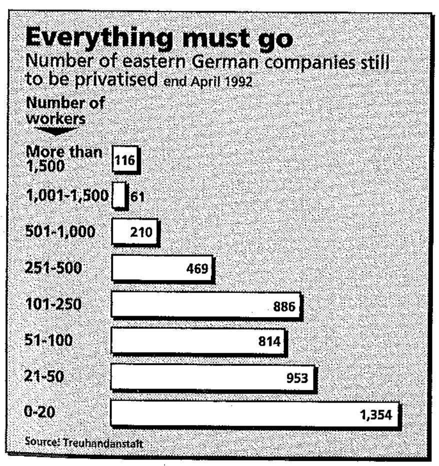
*1982-91 †1981-91

German managers keen to buy an eastern firm, seemed to have been a roaring success. It prompted 1,600 serious inquiries. The Treuhand quickly winnowed these down to 300 candidates with both the expertise and the money to buy and run a company. So far, though, it has not completed a single deal with any of these managers.

One frustrated official in the Treuhand unit set up in Berlin to deal with entrepreneurs and small companies lays most of the blame for this failure on other Treuhand officials. For a start, he says, they fail to provide individual bidders and small companies with enough information on the companies available. Then, when the west German entrepreneurs call up the Treuhand's regional offices for more information, they meet what he calls "unbelievably high walls of resistance". *The Economist* has obtained copies of letters to the Treuhand from disgruntled west German entrepreneurs complain that Treuhand officials have repeatedly failed to return telephone calls and that, when they do, officials know little about the companies they are selling.

The problem, says the Treuhand official in Berlin, is that the Treuhand's local offices are being pressed to sell east German enterprises as fast as possible. The easiest way to do this is to sell them to their existing managers, even though they may lack the skills and access to additional finance that will be needed if the firms are to succeed in the long term. Negotiating with west German bidders, who are more discriminating, is more difficult and takes longer.

Does it really matter who buys? In privatising eastern Germany's industries, speed certainly counts. In that respect, the Treuhand's priorities make sense. But when so many experienced west German entrepreneurs and managers of small businesses are eager to bid for eastern firms, some small delay might be worthwhile. It would be a shame if, for the sake of administrative ease, Treuhand officials were passing up the chance to create an eastern Mittlestand.



British sports cars

Lotus-eater

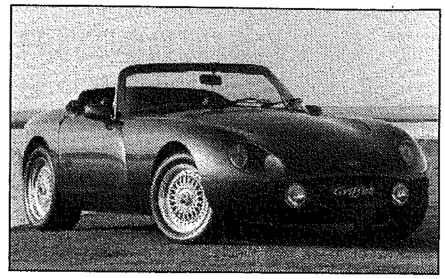
BLACKPOOL

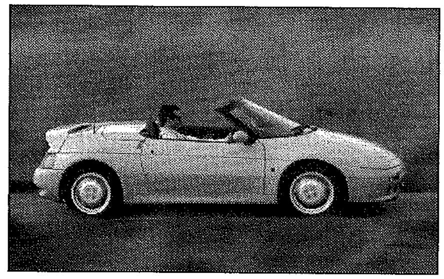
FRAZER NASH, Austin Healey, Triumph and MG may have pulled into the pits long ago, but a clutch of small firms still carries the chequered flag of Britain's sports-car makers. Lotus and TVR have led the way. Of the two firms, Lotus looked as if it had the best chance of surviving. Surely its giant parent, General Motors, had the money and expertise to succeed in the sports-car business. But on June 15th Lotus startled the motor industry by killing the Elan, its most popular model, barely two years after it went into production because the car was making heavy losses. Perhaps Lotus's managers should have taken a look at their much smaller, independent rival. TVR continues to make a profit selling a smaller number of cars to the same kinds of customers that Lotus was trying to woo with the Elan.

Both firms have steered their cars towards enthusiasts seeking more speed than is offered by the most popular sports car, the Mazda Miata, or MX-5 as it is known in Britain, where it costs £15,000 ($27,800). TVR's new £25,000 Griffith, for instance, hits 60 mph (96 kph) from standstill in 4½ seconds flat, half the time it takes the Miata. This market is small. Mazda sells 80,000 Miatas each year. TVR, which makes three basic models, sells fewer than 1,000. But sales to such enthusiasts can nevertheless be lucrative, and for companies bigger than TVR a snazzy sports car can boost the prestige of other models. That is why Britain's Rover (partly owned by Japan's Honda) is reviving the MG badge on a powerful, limited-edition sports car in October.

Lotus planned to produce 3,000 of its £22,000 Elans each year, but ended up making only half that number. But the firm's mistake was to apply GM's mass-production techniques to the Elan's tiny production runs. It spent six years and £30m developing the Elan and building a new, partly automated factory. After losing around £13m in each of the past two years, it stopped producing the Elan, reducing its 500-strong car-making workforce by 300, because it saw no chance of ever recovering its investment. Lotus will concentrate on its profitable R&D consultancy and on making its £48,000 Esprit supercar.

Compare the debacle at Lotus with the success of TVR, whose Griffith model took just 18 months and £500,000 to develop. Based in Blackpool, a faded seaside resort, TVR employs only 280 people but made an after-tax profit of £750,000 on sales of £15m last year. Most of that profit, says Peter Wheeler, TVR's chairman and owner, will be ploughed into R&D. That investment may look small, but it will enable TVR to renew its entire model range during the coming year, he claims.





Top, success; bottom, collectors' item

Car makers worldwide are trying to slim their manufacturing operations and make them more flexible. TVR's factory looks old-fashioned, but it is a showcase for the sort of "lean manufacturing" that will probably dominate the car industry within a decade. TVR has made a virtue of necessity. While Lotus had access to GM's huge parts catalogue to build the Elan, TVR has found it hard to excite components suppliers with its low volumes. Obliged to manufacture in-house, the firm now makes 70% of the parts that go into its cars. By doing this, TVR can also tighten its grip on quality.

TVR has not, however, splashed out on sophisticated machine tools to make its components. Such machinery can produce cheaper parts, but only at far higher volumes than TVR needs, as Lotus discovered to its cost. Instead, TVR's approach is to design parts with its own assembly techniques in mind. "Tooling a machine would take too long and cost too much," explains Mr Wheeler. That is why TVR builds its car bodies from composites which, although ten times more costly than steel, have exceptionally low tooling costs.

All this makes TVR highly labour-intensive. But for companies trying to become lean manufacturers, the crucial investment is in a flexible, innovative workforce. "We have clever people here, but they all have to use their hands. We wouldn't employ an engineer who couldn't weld," says Mr Wheeler.

TVR is close to the ultimate goal of lean manufacturing—to build products to order, at lower prices than much bigger rivals, and still make a profit. Every TVR is built to the customer's specification, which means a choice, for example, of a bewildering 12,000 colours. And lean-manufacturing techniques mean that TVR can quickly change

its product mix to suit the whims of the market.

Poor quality contributed to the Elan's downfall; the Griffith's quality, say industry insiders, is among the best in the business. But then TVR does have a secret weapon: Ned, Mr Wheeler's pointer puppy. Each day Ned selects a component from the factory and attempts to chew it to destruction. If a part can survive that, reckons Mr Wheeler, it can survive anything.

Biotechnology in Britain

Ready for cloning

BETTER late than never. Twelve years after American biotech firms started raising money through the stockmarket, British scientists are ready to do the same. The American experience is certainly encouraging: some 130 biotech firms have raised several billion dollars there. Now the British are coming. In July British Bio-technology of Oxford, Cantab Pharmaceuticals of Cambridge and Xenova will sell shares to be traded on America's NASDAQ market. British Bio-technology will also seek a listing on London's Stock Exchange.

If the three flotations are successful, some of Britain's other biotech firms are expected to follow (see table). Stockmarket flotations, in turn, could revive the interest of venture capitalists in British biotech start-ups. Until now they have had no way of cashing in on the few investments they have made in the industry.

Britain has been a world leader in genetic-engineering research, but its biotech industry has been tiny and its record miserable. Unlike their American counterparts, most British scientists have preferred cosy sinecures at universities to the risks, and rewards, of entrepreneurship. By American standards, their indifference to the commercial potential of their discoveries has sometimes been breathtaking. When one government-backed laboratory at Cambridge discovered monoclonal antibodies in 1975, it failed to file any patents on the breakthrough, forfeiting a potential fortune. Today monoclonal antibodies are used by biotech researchers around the world, in both corporate and university laboratories.

Government attempts to inject some commercial flair into British biotechnology have flopped. In 1980, the year Genentech dazzled America's scientists with a spectacularly successful stockmarket flotation, the British government persuaded a small group of financial institutions to join it in launching Celltech, a company created to exploit government-backed biotech research at British universities. With no stake of their own in Celltech, many British scientists resented the venture. The government wanted the firm to help other businesses get better access to university research, but its private shareholders naturally wanted it to generate profits, not help others. Torn by these conflicting demands, Celltech spent money wildly and by 1990 the firm seemed doomed. That year it lost £16.7m ($30m) on sales of £20m.

Since then, Celltech has been handed over to new managers, who have concentrated the firm's research efforts on treatments for hospital infections and reduced the firm's losses, though these remain large. The company is now aiming for a stockmarket flotation at the end of 1993. By then there may be plenty of other British biotech firms courting investors. Optimists like Peter Fellner, Celltech's boss, argue that Britain's biotech industry could be ready to take off, because the supply of both scientists and investors may be about to increase.

Budget cuts at British universities have threatened the secure tenure of many scientists, so more of them are eager to exploit their skills and knowledge in the commercial world. The London Stock Exchange is also drawing up new rules that would allow biotech firms to sidestep the exchange's usual requirement that a firm must have five years of profits before obtaining a listing. Because London's over-the-counter market has failed to attract enough investors, the stock exchange's decision could remove a big obstacle to financing biotech firms, none of which can yet boast any profits.

The one thing that could yet scupper the hopes of British biotechnologists is the waning patience of American investors. Despite the success of American biotech firms in raising billions of dollars, few have made any money. A record 36 American biotech firms obtained a stockmarket listing in 1991, and biotech firms sold an impressive $3 billion of new shares. That glut of new issues seemed to sate the appetite of investors. Since January biotech shares have fallen sharply relative to America's stockmarkets. Is this really the right time for British biotech firms to make their debut?

New British biotechnology companies

	Flotation date/ exchanges	Foundation date	1991 Sales £m	1991 Net loss £m	Equity finance raised so far* £m	Product areas
British Bio-technology	July 1992 NASDAQ/London	1986	5.2	6.1	73.2	Heart disease, cancer, AIDS
Cantab	July 1992 NASDAQ	1989	n.a.	3.0 est**	5.0	Transplant rejection
Xenova	July-Aug 1992 NASDAQ/London †	1987	1.4	2.0	12.0 est	Drug screening
Celltech	1993 NASDAQ†/London	1980	17.0	6.7	69.3	Septic shock
Agricultural Genetics Company	1993/94 NASDAQ/London	1983	1.5	2.5	17.0	Plants & seeds
Hiver	end 1993 London	1987	n.a.	0.3 est.	5.0††	AIDS

* venture capital and private placements ** excluding one-time licence †fee payment possible †† Including £4m private placement currently being raised
Source: Company reports

WPP

Preferably not

IT SEEMED a good idea at the time. In 1989 Martin Sorrell, rushing to turn his WPP Group into the world's biggest marketing-services conglomerate, paid $864m in a hostile takeover of Ogilvy & Mather, a New York-based advertising agency. That was not the good idea: most analysts reckoned the price was much too high. What did look like a good idea was Mr Sorrell's plan to help pay for the acquisition by issuing 214m convertible preference-shares. WPP got $347m in quick cash; the yearly 8¼% dividend the company agreed to pay preference shareholders was modest; advertising revenues were pouring in.

But like many of Mr Sorrell's manoeuvres, this one proved too clever by half. A year later the advertising industry went into a two-year decline, and WPP's cash flow evaporated. The group failed to make scheduled dividend payments in April and October last year. That triggered a clause in the preference shares giving full voting power to their owners. With just 60m ordinary shares issued, preference shareholders found themselves with 78% of the firm's voting rights. Now Mr Sorrell is seeking the second refinancing in a year to bail out WPP, and the company's fate is in their hands.

Until recently that was the least of Mr Sorrell's worries. In April 1991 he negotiated with WPP's 28 banks a restructuring of the group's $1 billion debt. Loan repayments were delayed; capital injected; loan covenants relaxed. But it was not enough. Last year was, contrary to his hopes, worse for WPP than the year before had been. Pre-tax profits fell 38%, to £56m ($105m), on revenues of £1.2 billion. Net cash flow was minus £24m.

After announcing those dismal results

Shareholders try to reach Sorrell

in March, Mr Sorrell again locked himself away with WPP's four lead bankers. On May 13th they emerged with a joint refinancing proposal. It had three main features. First, an issue of 250m new shares would be taken up by banks in exchange for writing off around $275m of the group's debt. According to WPP insiders, banks would also postpone principal repayments on its loans ($400m comes due next June) until 1997. Second, $150m in new loans would be provided to avert a cash crisis due to hit next month. Lastly—and here's the rub—preference shares would automatically be converted to ordinary shares at a rate of 1.7 for 1. All told, the firm's current ordinary shareholders would see their stake in WPP shrink to 14%; banks would end up with more than half the group.

Nobody is happy. But those who are squealing loudest are the preference shareholders. They would not get $46m in unpaid dividends; their voting rights would be reduced, leaving them with a 29% stake in the firm. Some preference shareholders want a final stake a third larger. A revolt is brewing. County NatWest, an investment bank which owns around 6% of the preference shares as a market-maker, reckons that some 40% of preference shareholders oppose the proposal.

If that many vote against it when asked to approve the scheme in July, the plan will be scuppered. If that happens, WPP has hinted it has other ideas up its sleeve that would not require shareholder approval. This is surely hot air. The biggest threat facing both ordinary and preference shareholders is that the banks will step in and seize control of WPP with the reluctant acquiescence of Mr Sorrell—or someone else. All shareholders might then not see dividends until after 2000.

That is what WPP wants the preference shareholders to believe. Indeed, in the tense negotiations that will come before the vote, the prospect of imminent doom will be Mr Sorrell's most potent threat: take what we are offering, he will say, or risk getting nothing. He might be bluffing. It is hard to imagine the stubborn Mr Sorrell not trying every avenue before surrendering control to his banks. But they may have their own ideas. Some of the firm's 28 banks are already said to prefer advancing some cash, then sacking Mr Sorrell and telling new managers to dispose of many of WPP's businesses.

Mr Sorrell is lucky that has not happened already. In most other industries, a company with $1 billion in debt and a £50m market capitalisation that was bleeding cash would be fast heading for receivership. But the only value of an advertising agency is its creative people, who tend to flee at the sight of bankers' pinstripes. If the bankers move in, they may find they have seized control of empty offices and design studios, and little besides. Ironically, Mr Sorrell, who has always been more of a number cruncher than an adman, may owe his survival to those same creative types he has often upset with his aggressive and penny-pinching ways.

Personal computers

Price slashers

TWO giants of the personal-computer industry, Compaq and IBM, are leaping down market, but seem unhappy about it. "Not cheap—affordable," is how Compaq executives described, through clenched teeth, a new range of personal computers which they unveiled on June 15th. Whatever adjective is used, the real point is that the new machines cost 25-50% less than the firm's top-of-the-line "Deskpro" range. IBM executives could not bring themselves to say either word. A week earlier they launched their newest computers under a pseudonym, "Ambra" (and even then they limited sales of the machines to Europe). One way or another, both companies would do well to overcome their embarrassment. Cheapness could, for some time to come, be one of the most exciting areas of innovation in the personal-computer industry.

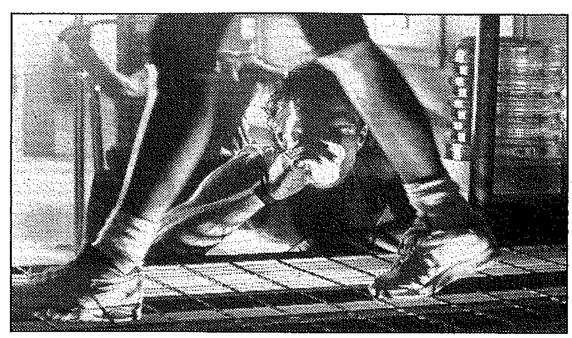
Part of the problem is simply that personal computers are running into a technological cul de sac. Over the past decade, tens of millions of them have been sold, along with hundreds of millions of word-processing, spreadsheet and other programs to run on them. Understandably, customers want to use their old programs on their new machines. But enabling them to do so greatly restricts computer makers' freedom to innovate. Worse, when innovation is possible, it is more easily and economically done by chip makers, not by the computer makers themselves.

Take four examples of innovations that will improve the personal computer over the next year or so:

- Video. Soon computer makers will offer machines that can display video on the desktop. Some will even be able to do video-conferencing. The key to providing these capabilities will be chips from Intel and, possibly, a small Silicon Valley chipmaker called C-Cubed.
- Local-area networks. Computer makers could soon offer machines that can be more easily plugged straight into an Ethernet local-area network—thanks to new chips from Advanced Micro Devices.
- Communications. New chips from Rockwell are making it cheaper than ever for computers to send faxes and to chat to each other over telephone lines.
- Faster processors. Intel is trying to convince computer makers to design machines which would let customers boost the power of their PCs by plugging in a new microprocessor brain. Intel, of course, hopes consumers will buy its own chips to do so. This could rob computer makers of the chance to sell new, improved models. They may have little choice but to go along, because their own industry has become so fiercely competitive.

By packing all the necessary circuits on to a single piece of silicon, chip makers can add functions to a computer while keeping it compatible with older programs—provided, that is, they can sell the chip to many computer makers at once, to cover the high development costs of the chip. This has not left much in the way of technical wizardry for computer makers themselves to do. One sign of the squeeze on their ability to innovate is that the last-minute changes to Compaq's new product range, which kept the firm's engineers working round the clock, concerned not arcane technical detail but the shape and colour of the machine's plastic cabinet.

Though both would deny it, IBM's Ambra and Compaq seem to be resigning



Other firms sweat, IBM glows

themselves to being mere packagers. They are aiming their new, cheap machines at small businessmen and individuals who want a personal computer at home to complement the one they use in the office. Ambra executives reckon that these customers know or care little about technical detail. Instead they hope that growing numbers of customers will shop for computers just as they do for hi-fis: mainly on brand image and only marginally on broad-brush comparisons of which brand does what at a given price. So far, many customers have been doing the opposite: ignoring established brands to buy on price alone.

To establish the Ambra brand image, IBM will spend roughly $15m on advertising this year in Europe. "Take your mind for a run," oozes its expensive television advertisement, over shots of beautiful, glistening bodies working out. Bar the slogan at the end, the advertisement could just as easily be touting anti-perspirant, running shoes or mineral water. From technical marvel to fashion accessory, the computer revolution has come a long way.

Servicing manufactured goods

Take it back, son

LOS ANGELES

ANTITRUST lawyers all over America have been sent into a tizzy by a ruling in the Supreme Court. On June 8th the court ordered Eastman Kodak to stand trial in a competition case about the repair of expensive photocopiers. The ruling could lead to billions of dollars-worth of lawsuits in many other industries. It has also thrown a spotlight on the increasingly hostile relationship in America between manufacturing companies and the firms that service and repair the goods which the manufacturers produce.

In 1987 a group of 18 companies which service the photocopiers made by Kodak sued it for allegedly demanding that buyers of the machines, most of them big corporations, either pay Kodak to service the machines or do the service themselves. If they chose to use an independent service company, it is alleged, Kodak refused to supply either the servicing firm or the customer with spare parts. In effect, Kodak was trying to get customers to agree not to employ any firms that competed with it for service contracts on the Kodak machines. Kodak persuaded a San Francisco court to dismiss the suit on the grounds that, even if it had acted as the 18 plaintiffs alleged, it would not have broken federal antitrust law. The Supreme Court has reversed that ruling.

Kodak may yet win the case. However, in the initial legal tussle, the Supreme Court rejected Kodak's central claim: that, because it had only a quarter of the total market for the sale of such large, sophisticated photocopiers, its 90% share of the market for servicing its own machines was not anti-competitive. Many economists would side with Kodak, rather than the court. They argue that consumers take servicing costs into account when buying equipment, so restrictive service agreements are not necessarily anti-competitive as long as there is competition in the equipment market itself.

One dissenting justice, Antonin Scalia, has already predicted that the case will unleash "a torrent of litigation". Lawyers acting for the plaintiffs agree, but prefer to call the ruling a victory for the consumer, whose service bills will drop. The market for servicing high-technology electronic products alone is worth roughly $100 billion a year. Thousands of independent contractors compete for the business, but the lion's share goes to equipment manufacturers.

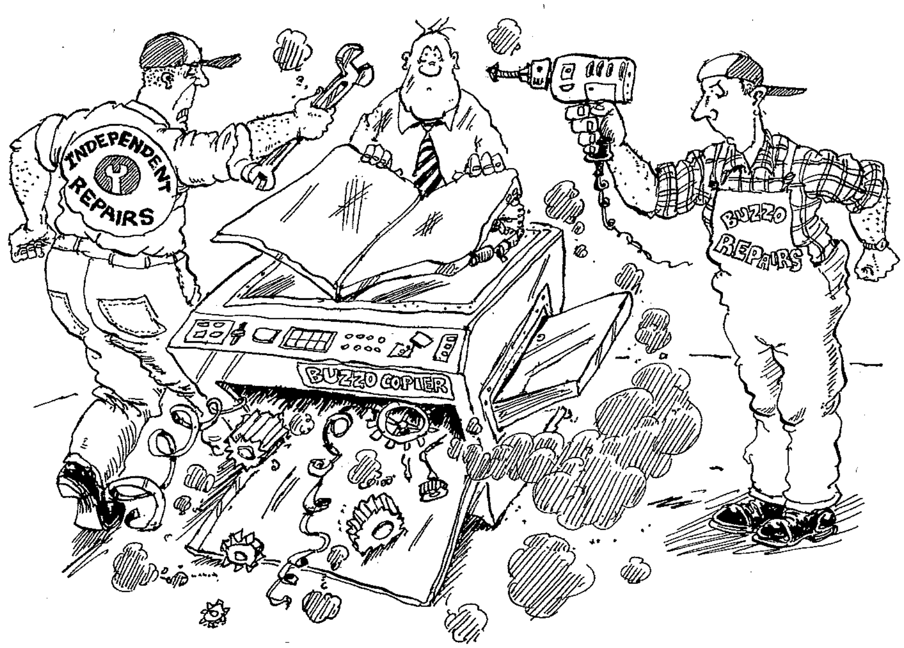
Roughly a quarter of the revenues of America's computer makers come from servicing and maintaining the machines they sell. Profit margins on service contracts can be as high as 50%. That comes in handy when profit margins on the sale of computers are disappearing because of recurring price wars. More than 20 computer makers, including Digital Equipment and Hewlett Packard, filed "amicus briefs" with the Supreme Court supporting Kodak; independent dealers predictably filed briefs supporting the plaintiffs.

Other industries may also be affected. Detroit's car makers also backed Kodak. In 1990 the retail market for car parts was worth $150 billion, about the same as that for new cars. Servicing cars came to another $100 billion on top of that. Detroit used to be happy to leave the repair business to mom-and-pop garages. No longer. Many independent distributors of spare parts complain that the big car makers are muscling in on their business.

Big manufacturers in Japan and Germany service nearly all their own products. But America's high job mobility and entrepreneurial traditions have encouraged many engineers in high-tech industries to set up service firms of their own, often to the fury of their former employers.

Not all manufacturers are keen on the repair and service business. Makers of cheaper electronic goods, such as washing machines, televisions and video-recorders, find it cheaper and easier to replace faulty machines with new ones, or encourage customers to buy a new model, than to bother with spare parts. But many states in America require that manufacturers honour warranties on anything they sell. To satisfy the law they have appointed dealers and service agents. And yet because the manufacturers of electronic goods now view many of their products as disposable, they are in direct conflict with the dealers who have to provide service under those warranties.

California's State Electronics Association recently filed a $600m class-action suit against 34 of the world's biggest consumer-electronics firms. It alleged that the firms fail to compensate dealers properly for warranty work on household items and that they overcharge for spare parts. One Los Angeles-based dealer calculated that the cost of ordering the 20 most important parts of a $300 Japanese television from its manufacturer was more than $800. Groups of dealers in Connecticut, Massachusetts and New York are also grumbling. The battle between those who make things and those who repair and service them has only just begun.



FINANCE

Undermining the foundations

Denied a bail-out for past losses, angry Lloyd's names will keep suing to avoid paying up. That will destroy confidence in the market

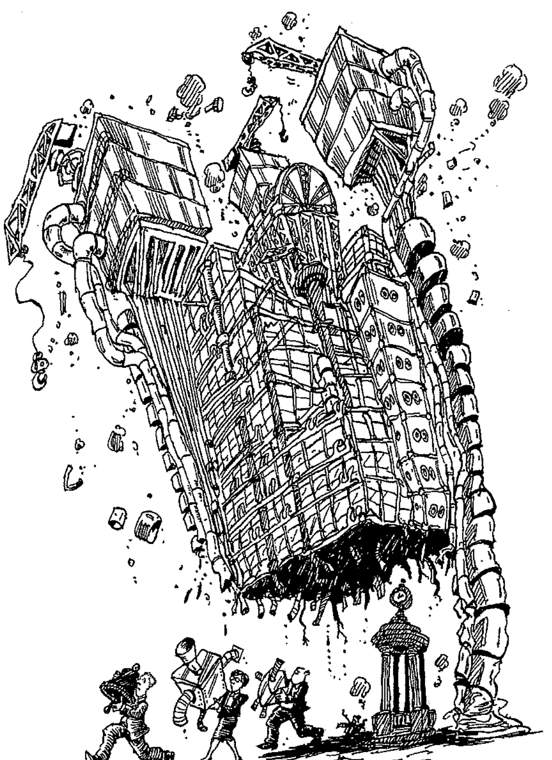
FOR two months Lloyd's has studied ways of helping its "walking wounded". That is the term its chairman, David Coleridge, uses to describe the 5,000-odd names—those mostly rich individuals who provide Lloyd's capital—who are facing losses of up to £500,000 ($930,000) apiece for 1989. Most were on syndicates managed by such defunct agencies as Gooda Walker, Feltrim, Rose Thomson Young and Devonshire, which specialised in excess-of-loss business. Much of that was reinsured in the LMX "spiral" that brought juicy commissions to brokers but landed names with ever bigger losses. The names' action groups reckon that underwriters who joined the spiral were, at best, negligent.

On June 18th Lloyd's admitted that, even with the help of S. G. Warburg, an investment bank, it had been unable to come up with a rescue plan. Mr Coleridge can now expect a roasting from names at the annual general meeting on June 24th. He is also expected to announce overall losses for 1989 then of £2 billion (the market keeps accounts three years in arrears). The release in July of two reports—one by Sir David Walker, the incoming deputy chairman of Lloyds Bank, on the LMX spiral, and another by Sir Jeremy Morse, the bank's outgoing chairman, on the market's governance—will increase the pressure. Yet Lloyd's failure over the bail-out was not surprising, for it faced irreconcilable interests.

In one corner stood the distressed LMX names who have been advised that they will win lawsuits for negligence. Alfred Doll-Steinberg of the Gooda Walker action group has made clear that his names would give up litigation rights only if the market relieved them of all losses above 10% of their underwriting limits. According to Chatset, an independent analyst, that would have cost £1.4 billion for 1989 alone.

In the other corner were the remaining names, who have been equally adamant that they are not prepared to fork out for a market rescue. Many of them have losses of their own—though distressed names observe that such losses would have been higher had underwriters not taken advantage of the LMX syndicates to dump their worst risks. But what doomed any rescue package was the announcement by Lloyd's two weeks ago of an extra levy—1.66% of underwriting limits for each of the three years of account from 1990 to 1992—designed to double its central fund to £1 billion. Names who are angry about this are in no mood for more levies to bail out their brethren.

The walking wounded say they are not looking just to fellow names for help. They reckon that the brokers and underwriting agencies which profited handsomely from Lloyd's in the 1980s should now pay some money back. Though they might chip in to Lloyd's hardship fund, agencies are unlikely to pay much. Sturge, the biggest, saw its share price drop by a third when it announced its results recently. Brokers too claim they are strapped for cash.



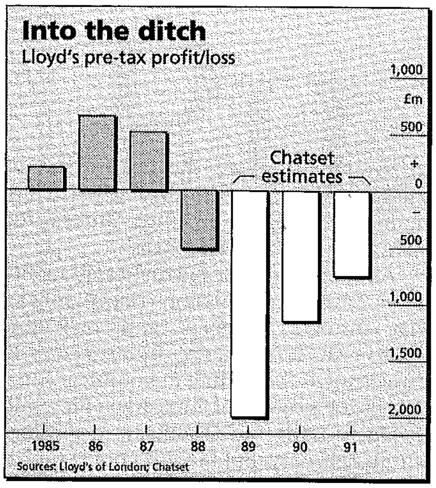
Another target for the distressed names is the errors and omissions (E&O) policies that insured members and managing agents against negligence claims. E&O syndicates might be willing to volunteer some money for the good of the market; they paid £116m to settle the Outhwaite negligence suit in February. But the E&O pot is probably no bigger than £500m. And the syndicates have reinsured some risks outside the market with German and Swiss reinsurance companies, which are unlikely to fork out without a court order. The leading Lloyd's E&O underwriter, Stephen Merrett, is taking a tough line on negligence claims. (He has also disclosed that he was paid more than £1m by his agency in 1989.)

Other possible sources of cash for the distressed names are the auditors to the LMX syndicates. The Corporation of Lloyd's is a harder target, since it is immune from negligence claims under the 1982 Lloyd's Act. Talk of a special loan that might be repaid by a levy on the market's future profits has now faded. In any case, commercial banks are not keen to increase their exposure to Lloyd's. They dished out many guarantees, secured on real assets, to names in the early 1980s, to enable them to underwrite business. These are now being called in.

A torrid summer ahead

The only help that Lloyd's is able to offer distressed names is better treatment from the hardship fund and from Centrewrite, the syndicate set up to offer quotes for assuming past open-year liabilities. The hardship fund has settled with fewer than 100 names; another 700 cases sit in its in-tray. It may attract more applications if it allows names to keep more income and a bigger house; but its freedom to do so is limited by the size of the central fund. Equally, Centrewrite, which has quoted such high rates that it has yet to take on any business, could offer more generous terms—but it might then have bigger losses to load on the central fund.

Lloyd's is left with the gloomy prospect that names will refuse to pay losses and will sue for most of the summer. In 1990 and 1991, according to Chatset, the market will record further losses of more than £1 billion and £750m respectively. Since the re-



sources of the central fund were boosted, the chances that the market will actually run out of cash are smaller than they were. Nevertheless, the Department of Trade and Industry may raise some awkward questions when it is asked to certify Lloyd's solvency at the end of July.

The market's troubles have also diverted attention from the job of implementing the Rowland taskforce report published in January. Lloyd's has decided to adopt the plan for a compulsory high-level stop-loss scheme for names starting in 1993. It has also made it slightly more generous, by lowering the point at which the scheme kicks in—from losses over three years that amount to 100% of a name's annual underwriting limit to losses over four years that amount to 80% of that limit. This may require a higher annual levy on names than the 0.5% envisaged by the Rowland group.

Other work, on such issues as improving names' rights, trading syndicate memberships and attracting corporate capital, has been derailed by worries over the implications in America. Because Lloyd's is based on sole trading with unlimited liability, it has been given tax breaks and an exemption from federal securities laws in America. It fears that any moves that make it more like a company, with individual shareholders, could put those benefits at risk. It is already being sued in several American courts, though this week it won a favourable judgment in New York.

Yet a move towards corporate membership and a blurring of the boundaries between Lloyd's and the insurance companies is the market's best bet. As names leave over the next few years, its capacity could shrink from £10 billion to £7 billion or less. Confidence among policy-holders is being dented by unending litigation and by concerns that names may withhold from Lloyd's the money it needs to pay its claims. Lloyd's could end up smaller than most British composite insurers. It is time for it to join their ranks.

Japanese insurers

In the land of the blind

TOKYO

THE slump in Tokyo share prices is cutting the ground from under Japan's life-insurance companies even faster than from under its banks. That is what the insurers' latest results show. The eight biggest, which account for more than 75% of the assets held by all 26 life insurers, saw unrealised gains on their holdings of Japanese shares fall by 61% in the year to March 31st, from ¥21.6 trillion ($153 billion) to ¥8.4 trillion. Even the city (large commercial) banks did not do that badly. Their unrealised gains fell 53%, from ¥22.7 trillion to ¥10.7 trillion. Both sets of figures were struck when the Nikkei share average was 19,346, by the way. On June 18th it closed at 16,046.

The reason for this terrible performance is not just Japan's brutal bear market. Life insurers also have themselves to blame. They built up their holdings of equities (nearly all of them Japanese) during the bull market of the late 1980s, and paid top prices to do so. Paul Heaton, a financial analyst at Smith New Court in Tokyo, calculates that between 1985 and 1990 life insurers raised their equity holdings from 15.1% to 22.1% of their total assets, measured by book value. This excludes the 5% of assets which the insurers placed in *tokkin* funds, most of them also invested in Japanese shares bought in the late 1980s.

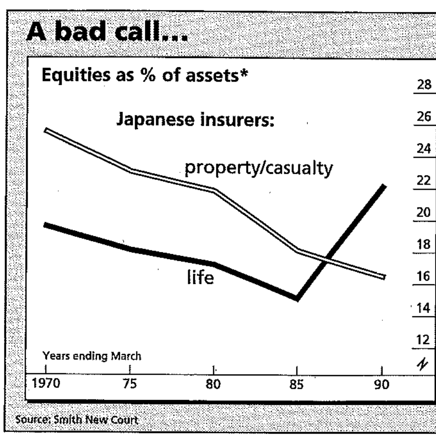
It is no wonder then that many life insurers, in penance for past recklessness, want to reduce their holdings of Japanese equities (including those held through *tokkin* funds) to 20% of total assets by 1995—despite the fact that Japanese shares are now a far better buy than they were a few years ago. The Nikkei is back at levels last seen in 1986. Life insurers hope that continued asset growth will allow them to reach this target by eschewing new share purchases, rather than by selling the shares they have. But the assets of the top eight life insurers increased by only 8.9% in the past fiscal year, the slowest growth since 1945.

In contrast to the life insurers, Japan's 14 publicly quoted property and casualty insurers were models of investing prudence. Resisting the lure of ever rising share prices, they stuck through the bull market to their traditional policy of allocating no more than a fifth of their new cash flow each year to Japanese shares. Equities actually declined as a proportion of their total assets, from 18.1% in 1985 to 16.5% in 1990, as the casualty insurers backed away from an increasingly expensive stockmarket. Consequently, their unrealised profits on Japanese shareholdings fell last year by 37%—a little more than half the life insurers' loss—from ¥12.55 trillion to ¥7.95 trillion. Tokyo Marine & Fire, which is the largest casualty insurer and writes nearly 18% of all policies, still had ¥1.95 trillion in unrealised capital gains at the end of March. This was more than any other Japanese company.

Mr Heaton views this relative strength as a reason to buy casualty insurers' shares. These companies are now selling at a discount to their unrealised gains (that is, their market capitalisation does not reflect their full value); in the late 1980s the biggest of them sold at premiums of as much as 40%.

Another reason to buy the shares is that the insurance business is highly profitable, and likely to remain so for longer than many assume. Thanks to strict regulation, property and casualty insurers, like life insurers, compete on service, not on price. Deregulation is coming, but its progress is glacially slow. Mr Heaton reckons that it will take at least five years to complete. The woefully undermanned finance ministry has too many other pressing problems to deal with, including an emerging bad-debt banking crisis at home. The insurance council, a committee appointed by the finance ministry, is about to submit a report recommending how to proceed with deregulation, but no bill is expected to be submitted to the Diet before 1995.

For fund managers who feel compelled, for whatever reason, to buy stakes in Japan's



...exacts its price

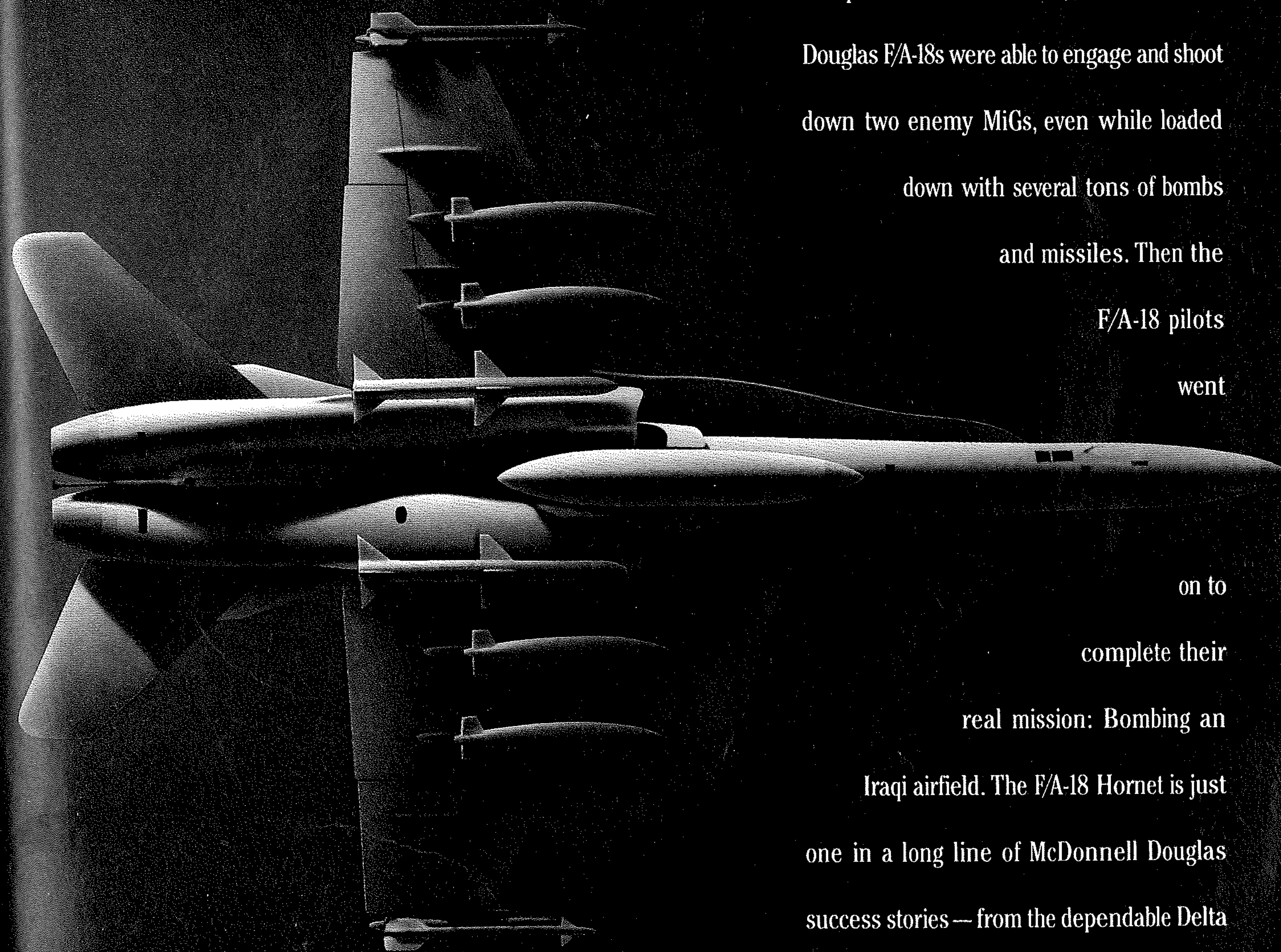
Life insurers, March 1992

% change on a year earlier	Assets	Net unrealised gains
Nippon	7.5	-54.5
Dai-Ichi	7.5	-62.8
Sumitomo	9.0	-75.4
Meiji	9.9	-49.1
Asahi	8.4	-65.5
Mitsui	9.9	-74.8
Yasuda	9.9	-59.0
Chiyoda	9.1	-75.8

Source: Smith New Court

*At book value

You're Carrying 4 Tons Of Explosives And People Are Shooting At You.



No problem. You're in an F/A-18 Hornet. In Operation Desert Storm, two McDonnell Douglas F/A-18s were able to engage and shoot down two enemy MiGs, even while loaded down with several tons of bombs and missiles. Then the F/A-18 pilots went on to complete their real mission: Bombing an Iraqi airfield. The F/A-18 Hornet is just one in a long line of McDonnell Douglas success stories — from the dependable Delta Rocket to the fearsome Apache. It's this record of proven performers that has made us a world leader in aerospace technology.

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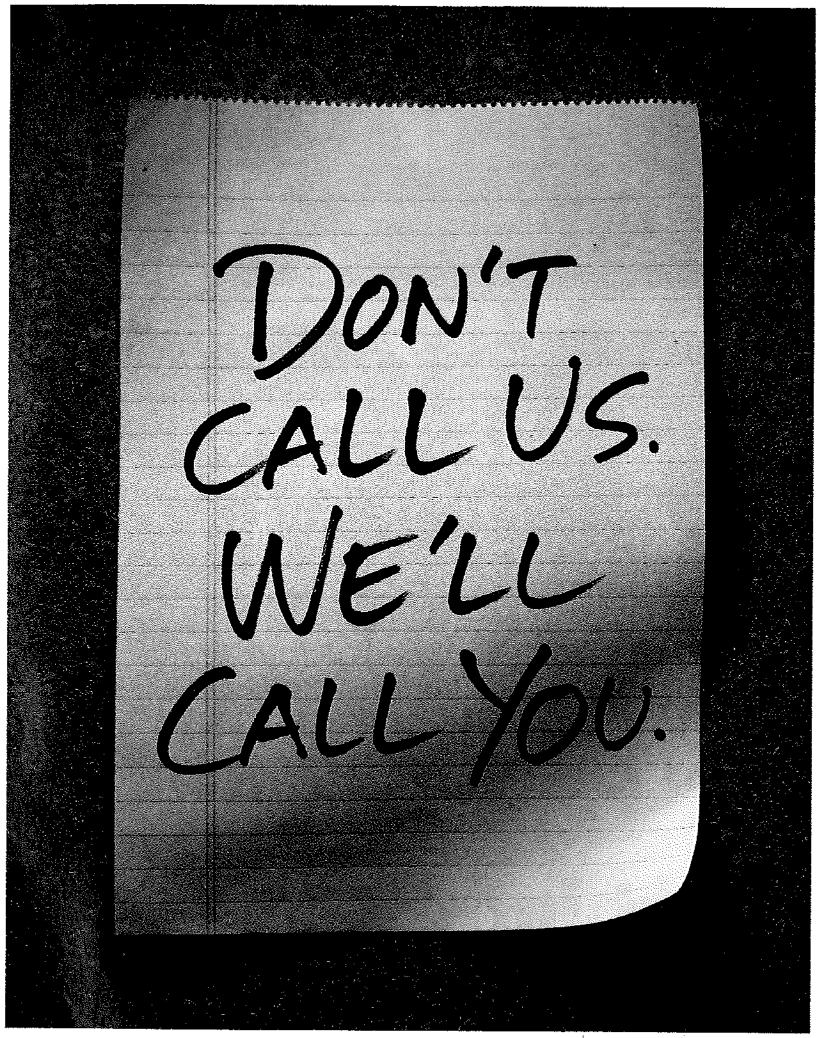

When you set yourself to the task of dragging business banking kicking and screaming into the 21st century, some interesting things happen. Not the least of which is that an old, hackneyed, Hollywood slam can suddenly become something akin to a corporate motto.

Such is the nature of change. (You remember change. It's that thing that has kept you perplexed, bewildered and astonished ever since you set foot in the business world.)

And speaking of change, when was the last time your business banker called you before being asked? Gave you an answer before you asked a question? Or offered you a solution before you saw a problem?

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A single market for bank shares?

European and Japanese bank shares are beginning to behave more like American ones. That does not mean they will mimic the American rally

MARKET FOCUS

FEW investments in the past 18 months have paid off as handsomely as a bet on American bank shares. An index tracked by Salomon Brothers has jumped 123% since October 1990. America's stockmarket, as measured by the S&P 500, rose 35% over the same period. The rally snapped a record of underperformance that had lasted for half a decade.

Investors scouting for similar windfalls in other countries have been disappointed. Outside America, most countries' bank shares have slumped in absolute terms, and resolutely underperformed their local markets. That should be no surprise. Bank shares march to the beat of their local economies rather than in time with each other. Banking may seem like a global business, but the market for bank shares certainly is not.

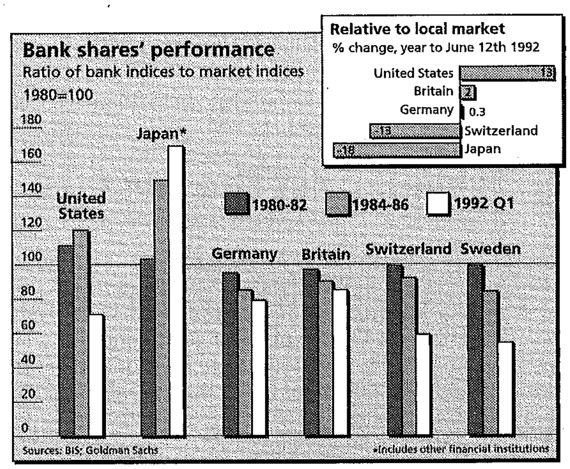
That may be changing. Though banking itself is arguably less global than it was, now that both third-world debt and banks' international ambitions have retreated, ownership of banks is becoming more globally spread. Investors have always used different standards for valuing different countries' bank shares. They are now starting to use British and American methods on other markets. Prices will not converge (national economies will always skew them, and national quirks persist), but methods for valuing bank shares will move closer. Once they do, the shares of a profitable Japanese bank may imitate those of an equally robust American one.

The adjustment will be painful for some. In formerly high-flying markets like Japan's, convergence means lower valuations. It does not mean that non-American bank shares will see their losing streaks come to an end, like their American brethren. Local markets and individual performance will still dictate prices.

In Britain, America and some continental European countries, bank shares usually trade at lower price/earnings ratios than the rest of the market, and offer higher than average dividend yields. Investors reckon that banks are riskier than other investments and likely to produce smaller capital gains.

In Germany and Japan, bank shares trade at a premium to the market. German banks own big chunks of the country's industry (but do not declare income on their holdings). Investors buy their shares partly as a proxy for buying industrial stocks directly. Japan's system of cross-shareholdings between banks and industrial enterprises also underpins the value of bank shares. In addition, Japanese banks have relied on big undisclosed portfolios of securities to bolster earnings in bad years and to shore up capital.

In both countries bank shares loom large in the stockmarket. Japan's banks account for 19% of total market capitalisation, Germany's for 15%. Their share prices tend to track the broad market fairly closely. In America, where bank shares make up just 3% of the market, and in Britain, where they account for 6%, they are more likely to trade independently.



Differences in accounting and regulation preserve the gaps among the share values of banks in different countries. German banks, for example, transfer an undisclosed share of profits to hidden reserves. That cuts their tax bill, but obliges them to tap their shareholders often for additional capital. Japan's regulators do not encourage banks to set aside provisions for possible loan losses. Investors must guess how much banks will need to cover bad loans, and cut their estimates of profits accordingly.

Beneath these nationalist tendencies, however, lurk forces that will drive bank shares closer together. In Japan the share prices of city (large commercial) banks have slumped to 44 times earnings, from a high in 1987 of more than 130. That still leaves their p/e ratios three times greater than in America, but the gap is likely to keep narrowing. Nozomu Kunishige, an analyst at Kleinwort Benson in Tokyo, points out that corporations, which hold more than 60% of bank shares in Japan, are starting to liquidate their portfolios. As shares trade more widely, their premium will diminish. New share issues by Japan's capital-strapped banks will cut prices further. As prices fall relative to the market and banks gradually raise dividends, Mr Kunishige reckons that Japanese bank shares will begin to trade more like those of American banks.

In Europe, bank shares are following suit. German banks appear to trade at bigger premiums to book value than British or American banks. But if their book value is adjusted to include the value of their securities and property holdings, the premium becomes a discount. Steven Davis of DIBC, a consultancy in London, believes that European banks' p/e ratios are moving towards 8-12, on average, and that market capitalisations are converging towards adjusted book value. Much depends on defining the adjustment.

Even so, banks will not escape the tyranny of local conditions. The American rally owes much to the gloom that preceded it. Banks had stumbled into several disasters, including bad loans to developing countries and to property developers. They were going bust in record numbers and investors feared for some of the biggest. The market value of money-centre banks sank to half their book value in September 1990.

Things were bad, but not that bad. Interest rates began to drop, and regulators insisted on banks making big provisions against bad loans. Competition eased. The thrifts debacle wiped out a host of banks' rivals. Strong banks began to prey on the weak, eliminating competitors and cutting costs. With economic recovery now under way, money-centre banks are trading at about 1.2 times their book value. Regional bank shares are even stronger, at 1.6 times book value.

In Europe the traumas came later and (outside Scandinavia) were less severe. In Japan they are just beginning. Banks in both places will bounce less than in America, and later. All banks face tougher competition, and nasty surprises may lurk in their books. In an era of slow growth and higher capital requirements, profits will be scant. Banks can boost them by cutting costs and merging with rivals. American banks are beginning to do so; continental and Japanese banks are lagging. Until they catch up, do not expect them to match the American rally.

imploding financial-services business, the shares of property and casualty insurers may indeed be a good bet. Most of the firms look better off than the banks; they do not appear to have bad debts on anything like the same scale. And life insurers are all mutually owned by their policyholders, giving investors no foothold.

Whether casualty insurers' shares are actually cheap is another matter. They still sell on a prospective price-earnings ratio of around 36. Like the life insurers, they face declining asset growth. In Japan, property and casualty insurance companies also offer savings policies—another cause of difficulty. These policies are not being renewed, because better rates are becoming available elsewhere. Tokyo Marine & Fire would lose ¥540 billion this fiscal year if none of its maturing savings policies was renewed. The worst of the casualty insurers' problems may be still to come.

GPA Group

Down to earth

THE flotation of Ireland's GPA Group, the world's biggest aircraft-leasing company, was aborted on take-off on June 18th. The worldwide sale of almost one-third of the group's shares would have valued the firm at up to $3.5 billion. But just hours before the shares were due to be priced and trading was to begin, Tony Ryan, GPA's chairman, said: "It would be unwise to proceed with the offer in circumstances which are adverse to both the company's and the shareholders' interests."

Stockmarkets, already rocky, rocked a bit more on the news. For GPA itself, with huge financial commitments to pay for aircraft already ordered, the grounding means big trouble ahead. What went wrong?

Maurice Foley, GPA's chief executive, said that although interest was initially high, stockmarket jitters and fears about the future of the American airline industry suddenly turned off American institutional investors. At the 11th hour about 30m of the 80m shares on offer were still on the shelf. Of the shares that were taken up, Japanese investors, mostly individuals, accounted for about half. Investors in the United States and Britain were willing to buy only a feeble 13m shares—well below what GPA had hoped for. "The offer", laments Mr Ryan, "did not attract the volume or geographic spread of institutional support ... deemed appropriate."

This might not have mattered had the offer been underwritten according to normal British practice. But as the GPA flotation was a global issue, the company decided to follow the American custom of "book-building"—assessing the level of investor de-

Ryan says no deal

mand in the days before the flotation, then striking the price and selling the shares at the last moment. In the event, with institutional demand well below expectations, GPA had to withdraw. The terms of the offer prevented GPA from extending the issue or scaling it down, the firm said.

GPA needed to go public to help finance the $12 billion-worth of new jets it has on order. It also has options to buy another $9 billion-worth. In all, GPA's orders account for about 10% of all the jets that aircraft makers plan to build between now and the end of the century. GPA was founded in 1975 by Mr Ryan, who owns 8% of the company; employees own another 8%; the rest is divided among firms as diverse as Air Canada and Mitsubishi Trust & Banking. Some of these shareholders wanted to use the flotation to recover part of their investment by selling their stakes; some had agreed to hold back in order to help the flotation.

Although the airline industry is in the doldrums, GPA has always claimed that its leasing business is largely immune. It rents out jets to airlines on an "operating" lease, typically for about seven years. GPA remains the owner of the jet. At first, the Irish company bought second-hand aircraft but now buys new ones. Its current fleet numbers 400 jets, and another 500 are on order.

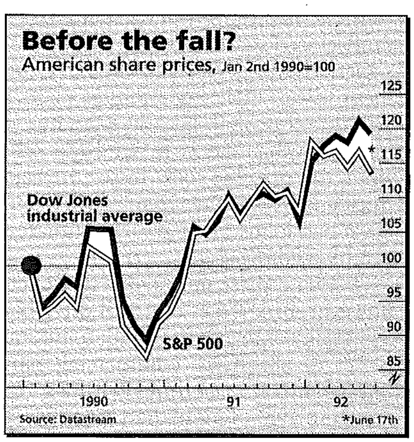
American investors clearly do not believe that GPA is as immune to the vagaries of the airline business as it thinks. They have good reason to be cautious. American airlines, fighting yet another price war, are on course for a third year of big losses. In the

Well past the best

NEW YORK

EVEN before GPA cancelled its planned flotation, share prices were falling in Tokyo and New York, London and Paris. Investors in at least one of those markets should not have been surprised. While America's Dow Jones Industrial average has soared of late, other indices have dropped: a classic sign that all share prices were set to tumble.

Despite the Dow's slide on June 17th, when it shed 42 points, it is still within about 3.7% of its peak, on June 1st, of 3,413.21. The S&P 500, the Wilshire 5000, the New York Stock Exchange Index and the NASDAQ composite index all peaked



in late January or February.

The last time the Dow and the S&P 500 diverged so widely, in 1989, share prices fell sharply. That pattern holds for the past decade, according to Rao Chalasani, of Kemper Securities.

The indices diverge because the S&P 500 is weighted to reflect the different market capitalisations of its 500 stocks, whereas the Dow is an unweighted index of 30 stocks. If just a few rise strongly, they pull the whole Dow up. Most recently General Motors, Caterpillar, Disney, Merck and Coca-Cola have been superstars. But blue chips cannot resist a weak broader market for ever. When the Dow plunged this week, General Motors and Caterpillar helped it down.

Small investors' fixation on the rising Dow has boosted share prices enormously. Retail equity mutual funds took in $29 billion in the first four months of 1992, more than enough to absorb the $25 billion in new equity that companies issued. Here another warning signal flashes. According to Ned Davis Research, a Florida firm, the annualised dollar volume of new equity offerings as a percentage of personal savings historically peaks just before the market does. That ratio is now 59%. Or about what it was before the stockmarket crash of 1987.

past two years they have made a combined loss of nearly $6 billion. GPA says that only 12% of its business is with American carriers (many of its aircraft are leased to developing countries), so it finds such worries about its offer hard to understand.

Where does GPA go from here? Mr Foley says the company still intends to go public, but clearly that will not be for some time. In the meantime, he claims, GPA has plenty of stategic options. It has continuing lines of credit from its bankers, which Mr Foley says will be sufficient to meet the company's demands. Those demands are hefty. Over the next ten years the company will need $1.2 billion a year to pay for its firm orders for new jets. Last year, says Mr Foley, GPA generated $1.6 billion in cash. Many believe, however, that GPA is seriously overstretched.

The company could also continue to tap capital markets, sell some of its shares privately or issue more of its "securitised" aircraft-leasing funds. These involve selling to a group of investors aircraft that are already leased to an airline. The investors then collect the rent on the aircraft. The first such fund, a $521m issue involving 14 aircraft leased to 14 carriers around the world, was successfully launched earlier this month and assigned a preliminary AA credit-rating by Standard & Poor's.

Another strategy would be to cancel some of the orders that it has with Boeing, Airbus Industrie, McDonnell Douglas and Fokker. GPA has already "rescheduled" some orders, and cancelled some of its options. But more cancellations would be costly, as GPA has already paid some $957m in non-returnable deposits. If the company cannot raise the finance it needs to take most of the jets it has on order, it will have no option but to clip its own wings.

Swedish banks

Scuppered

COPENHAGEN

SCANDINAVIA'S banking woes are deepening. On June 16th two of Sweden's biggest banks—Svenska Handelsbank (SHB) and Gota Group—reported results for the first four months that were sharply worse than a year earlier. Not long before, that country's largest and most prestigious bank—Skandinaviska Entskilda Bank (SEBanken)—said it had gone into the red for the first time since it was formed, in 1972, through a merger. In November 1991 and April 1992, the government had to rescue two other banks, state-owned Nordbanken and Forsta Sparebanken, at a cost of about SKr30 billion ($5 billion). Of the lot, only Svenska Handelsbank is now in profit. Finland and Norway have become banking graveyards. Will Sweden follow?

No, because its big banks and its economy are far stronger. This is, nonetheless, Sweden's worst financial crisis since the 1920s. Credit losses are soaring. SEBanken provided SKr2.5 billion (about 2.45% of outstanding loans) for bad debts in the first four months of the year, up from SKr1.58 billion a year earlier. It expects the full-year figure to be treble that.

Swedes do eye neighbouring Norway, dissimilar though the countries are in many ways, for evidence of what happens when banks are exposed to a collapsing property market and a strongly disinflationary economy. Observers recall that in 1990 and 1991 Norway's banks, supervisors and central bank all repeatedly sought to calm depositors' fears. And that, on one occasion, a bank collapsed within two days of soothing official words.

Also, the timing of Norway's difficulties is disturbing. The Norwegian crisis began in the finance companies, where losses peaked three years before the banks' losses reached

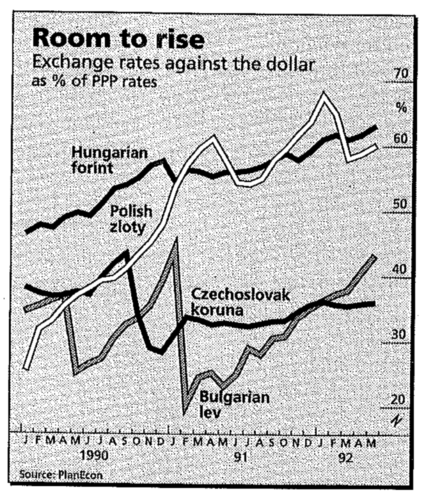
Buy now, while currencies last

CURRENCY risk matters to western businessmen who are thinking of investing in Eastern Europe. If a local currency is devalued, an asset bought today will be worth fewer dollars tomorrow. They may be cheered by a study by Jan Vanous, the head of PlanEcon, a research firm in Washington, DC. Mr Vanous concludes that all the East European currencies are undervalued against western ones. This could offer western investors big capital gains in the future.

Economic theory argues that in the long run currencies should move towards their purchasing-power parities (PPP), the exchange rate that equalises the prices of an identical basket of goods and services in two countries. If a currency is below its PPP against the dollar, then it is likely to rise in real terms—either through an increase in its nominal exchange rate or through faster inflation than in America.

Mr Vanous reckons that all the East European currencies are way below their PPPs. Grossly overvalued for years, when their economies were centrally planned, currencies fell too far when they were set free. Mr Vanous estimates, for instance, that the PPP of the Czechoslovak koruna was 10.37 korunas to the dollar in May, compared with a market rate of 28.80 korunas. This makes the koruna 64% undervalued against the dollar.

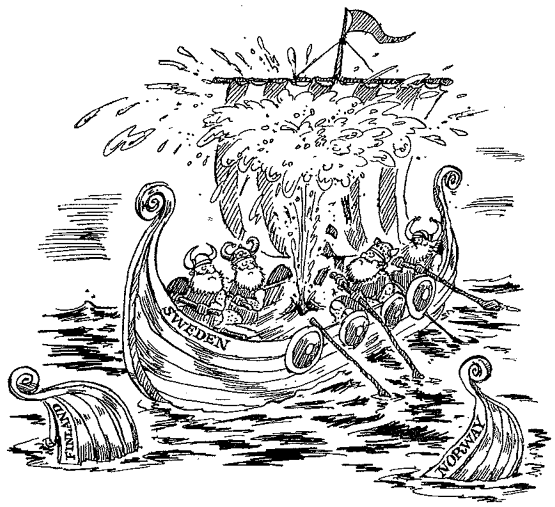
If a currency is undervalued, its real exchange rate should rise. This is exactly what has been happening in Eastern Europe. Nominal rates have fallen, but by less than the difference in inflation with America. The Hungarian forint's exchange rate in the market has risen from 47% of its PPP in early 1990 to 63%, the Polish zloty from 26% to 60%. Western businessmen complain that rising real exchange rates have reduced the competitive advantage that manufacturing enjoyed in these countries. Despite their strengthening, however, currencies remain undervalued; there is plenty of room for further appreciation.



The more undervalued a currency, the larger the potential gain. The forint is the least underpriced—partly because its reforms are most advanced and Hungary has attracted the biggest inflow of foreign capital. The Czechoslovak koruna is the most undervalued; this fits with the fact that average monthly wages in Czechoslovakia are about 40% less, in dollar terms, than in Hungary and 20% less than in Poland. The Polish zloty, though undervalued against the dollar, looks overvalued relative to other East European currencies: Poland's economic prospects are dimmer than theirs.

Mr Vanous's estimates should be treated with caution, for PPPs are notoriously tricky to calculate. There is some support for his conclusions, however, from no less authoritative a source than *The Economist's* Big Mac index. This shows that the forint is 24% undervalued against the dollar, the koruna 30%. Food for thought.

"The Role of Exchange Rates in Western Investment Decisions in Eastern Europe". By Jan Vanous. PlanEcon, May 1992



their worst point. Within a few months after November 1990, nearly all the independent finance companies in Sweden had gone bust. That suggests to some that Swedish banks' problems will grow for another year and a half.

For all their capital strength (Gota claims capital equal to 11.8% of assets), Swedish banks have not been rigorous providers against doubtful debts. Coronado, a Swedish property group, collapsed at the beginning of June, with potential losses for the banks of up to SKr4 billion. Banks had made, at best, tiny provisions against their Coronado loans. The reason, according to SEBanken, was that until the last moment they hoped for a restructuring.

If this is widespread practice, the Swedish banks could be pushing some large provisions ahead of them as the property slump deepens. In Copenhagen, where banks have sustained heavy losses without getting into terminal trouble, there is much tut-tutting over Swedish laxness. In a case like Coronado, the Danes' more conservative supervisors would have compelled their banks to make hefty provisions long before the company had reached the point of no return.

Swedish banks are now taking steps to neutralise, at least, their losses. Nordbanken and Forsta Sparebanken are spinning off their dubious property-related loans to new "bad banks". SEBanken is doing something similar, and hopes to divest its properties later at a profit.

Gota Group's solution is the most unusual. It announced this week that it is insuring its loan portfolio against loss over the next four years. This is the largest financial insurance exercise of its kind, providing Gota with total cover of SKr13.5 billion. And one of the most expensive: premiums are likely to total SKr8 billion-10 billion. At a price, Gota will be able to spread its credit losses over the period, reducing uncertainty about the harm that bad debts will do to its capital base.

Gota is better placed than most to insure its risks. Trygg-Hansa, an insurance and pension-fund group, owns 43% of its capital and has 48% of its votes. In early April, when market rumours threatened Gota's public reputation, Trygg-Hansa offered to buy the rest of the shares, and the offer is still open. A special-purpose vehicle, owned by two unnamed European companies and J.P. Morgan, an American bank, is writing the bank's credit insurance, and Trygg-Hansa will carry about 11% of the cover. The government has given warning that it is disinclined to carry out any more bank rescues. This is one group that seems to believe in the government's resolve.

Europe's postal banks

Under fire

PARIS

ON JUNE 26th Seoul will play host to an unusual conference. The South Koreans are thinking of reintroducing a postal banking service, and have invited a horde of foreign academics and practitioners to advise them on how to do it. Europe provides a cautionary tale. Across the continent, post offices are trying to expand their banking business, and banks are doing their best to stop them. The two sides have already clashed in France and Belgium. Now it is Germany's turn. In May a group of nine German commercial banks took the country's Postbank to court, accusing it of unfair competition.

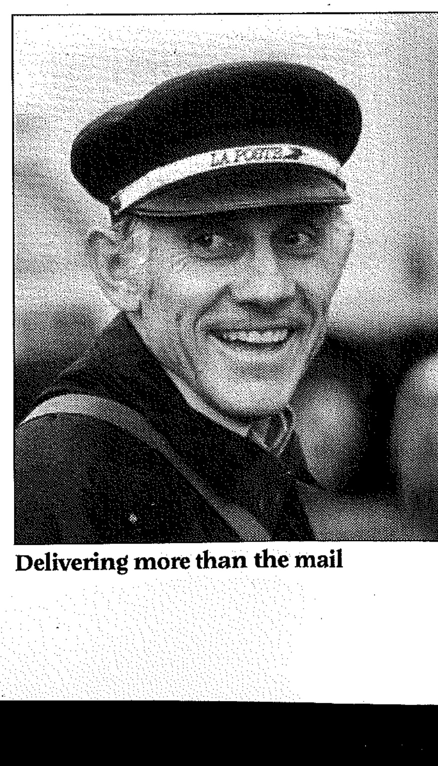
Some European countries have avoided similar rows by privatising their post offices' financial activities. In 1989 the Dutch Postbank merged with the Nederlandse Mittenstandsbank to form NMB Postbank, Holland's third-largest bank. The two are now part of the ING banking and insurance conglomerate. Britain has also privatised its postal bank, the Girobank, which was sold in 1990 to Alliance & Leicester, a building society. Other countries have tried to put some distance between banking and normal postal business. In Spain, for example, the Caja Postal has been incorporated into a state bank-holding company called Argentaria.

Dieter Elixmann, a German researcher, has identified at least three other sorts of arrangement. First, there are countries like Luxembourg and Switzerland, which still have mail, telecoms and banking services wrapped up in a monolithic public body. Then there are countries like France and Italy, which have separated their telecoms activities, leaving mail and financial services combined. Lastly, there is Germany, which has broken up its public administration into three separate entities—telecoms, mail and Postbank—each with its own balance sheet.

Until recently, Europe's commercial banks have ignored the Postbank threat. They are kicking up a fuss now for two reasons. One is that post offices are marketing their financial services more aggressively than before. Under pressure from governments to break even, the postmen are betting on banking to compensate for profits lost in mail-handling and telecoms, which are slowly being prised open by the European Commission.

Banks are also upset by the post offices' forays into new financial products, such as life insurance, which they had previously left alone. Spain's Caja Postal has even gone into leasing, asset management and property consulting. The postmen have no alternative. With European savers looking for high-yielding assets, post offices must offer something better than their traditional low-interest savings accounts.

The real trouble lies in establishing whether a post office's banking activities are being cross-subsidised by its mail or telecoms operations. Postal banks may not pay a market rate for the use of post-office counters, staff and mailing services. The Belgian Bankers Association has complained to the European Commission that the Belgian post office's financial activities are unfairly subsidised—but it has found



Delivering more than the mail


J. Fretz

Post offices' financial services

Country	Cash card	Savings account	Securities	Loans
Greece	x	x	x	x
Portugal	x	✓	x	x
Ireland	x	✓	x	x
Luxembourg	✓	x	x	x
Italy	x	✓	x	x
Belgium	✓	x	x	x
France	✓	✓	✓	x
Germany	✓	✓	x	x
Denmark	✓	✓	✓	✓
Spain	✓	✓	✓	✓
Holland *	✓	✓	✓	✓
Britain *	✓	✓	✓	✓

* information only; post banks privatised
Source: French Bankers Association

few hard figures to support its case. In France the banks have made the Poste abandon ambitious plans for a new sort of current account, but they are still alert for further threats of "unfair" competition.

Banks are not satisfied even when postal banks are separate public bodies. Germany is a good example. After it was established as an independent body in 1990, the German Postbank decided to improve its services. In July 1991 it announced that clients would be allowed to have a DM10,000 ($6,000) overdraft for up to 90 days on certain accounts. This infuriated the commercial banks, which noted that the rules had been intended to stop the Postbank from making loans. The Postbank claimed that an overdraft was not quite the same thing. After months of semantic argument, the banks have turned to the courts.

That will not deter the Postbank. It wants to launch a range of life-insurance products before the end of the year. This makes the other banks nervous, the Postbank says. They fear that it will turn into a savings giant like Japan's postal savings system. On the most recent estimates (for the end of May), that holds a cool ¥158 trillion ($1.24 trillion) of deposits.

What really worries the banks, however, is that the Postbank can still dip into the state's purse. In 1990, the latest year for which figures are available, it made a loss which was conveniently covered by a subsidy from Germany's profitable telecoms monopoly. The bank admits it may need another big subsidy for 1991. Other publicly owned postal banks benefit from state largesse too, often leaving even state-controlled commercial rivals at a disadvantage. Only when all European countries follow the Dutch and British examples and privatise their postal banks can the postmen expect a welcome from the bankers. South Korea, you have been warned.

Pension-fund robbers

NEW YORK

ROBERT MAXWELL showed how easily bosses can pillage their companies' pension funds. Many pension-fund managers do a fair job of it too, and perfectly legally. They may be costing pensioners in America more than $15 billion a year, suggests a new study*.

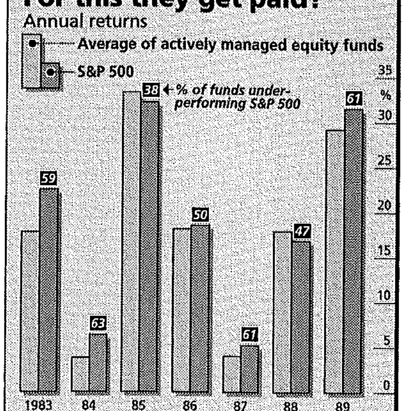
Published by the Brookings Institution, a Washington think-tank, the paper starts by asking how well pension-fund managers perform. American companies have some $2 trillion of pension-fund assets, which they mostly pay outsiders—including banks, insurance companies and investment advisers—to manage. About $1 trillion is invested in equities, the bulk of it by investment advisers who follow active stock-picking strategies.

When pitching to run a company's fund, most of these money managers claim that they will beat the returns on the S&P 500. The authors looked at 769 all-equity pension funds run by 341 different managers to see if they did.

Between 1983 and 1989, the returns (including dividends but ignoring management fees) earned by managed funds averaged 1.3% less than the returns that would have been earned by simply investing in the S&P. When the average return was weighted by the size of each fund, active managers earned 2.6% less than the S&P; in other words, big funds did even worse than small ones. Subtract management fees (another 0.5% or so) from active managers' returns and the S&P looks even better.

All money managers were not equally bad, the study admits. By studying how management firms performed in the previous three years, and hiring one that earned among the highest 25% of returns, a fund could expect to outperform the average by 1% in the next year. A useful gain, but still not as good as the S&P, which beat the average by 1.3%.

For this they get paid?
Annual returns



Source: Lakonishok et al, Brookings Institution

If the pension funds had put their money into investments that mimic the S&P, they might have been $15 billion a year better off. Would the pensioners themselves have been better off, however? That is less clear. More than 80% of pension funds pay an agreed fixed benefit which does not reflect how well—or badly—the fund invests. In most cases, poor investment merely reduces the pension-fund surplus (its value above what it owes to current and future pensioners). Legally, the surplus belongs to the firm (that is, its shareholders), though management may feel morally obliged to pass some of it to its pensioners.

Why do firms continue to hire active money managers if their results are usually poorer than those on indexed investments? The authors come up with various interesting suggestions, some more convincing than others.

Pension-fund managers are hired by company treasurers, among whose goals are likely to be keeping their jobs and avoiding blame for bad performance. Many treasurers find outside fund managers to be useful scapegoats. Some fear that adopting a passive investment policy might send a message that big treasury units are superfluous. Active outside managers can be counted on to need lots of strategy sessions and monitoring (as well as lunch). And treasurers' bosses may be uninterested in maximising pension-fund returns for another motive: big surpluses can make a company the target of an unwanted bid.

There may also be duller reasons. Perhaps the period studied was unusually grim for active fund managers. The S&P performed spectacularly for much of it, and even so the average actively managed fund occasionally beat it. And the study tracked individual funds, not fund managers; the latter may have outperformed the average more consistently, changing firms frequently to fool the statisticians. Perhaps company treasurers are guilty of no more than naivete in believing one fund manager after the other who promised the moon. They would not be the first.

*"The Structure and Performance of the Money Management Industry." By Josef Lakonishok, Andrei Shleifer and Robert Vishny. Brookings Papers on Economic Activity, 1992

The fruitful, tangled trees of knowledge

The world's telephone systems are quickly being overgrown by the data networks springing up within and around them

ONE day telecom companies will earn more money carrying data from chip to chip than by carrying voices from telephone to telephone. But by then—quite possibly before the turn of the century—the telecom companies will also have lost their supremacy in communications. Networks owned by companies, universities, governments and housing co-operatives will provide crucial links in shipping information across campuses, cities and continents. The reason is that computers pass information to and fro at rates that would dizzy the most talkative telephone user. Making the most of this loquaciousness requires a new world of networks, ranging in size from a tangle of cables joining a laboratory's workstations to a satellite system linking a multinational's laptops.

The new networks provide magnificent opportunities for innovation. For the most part, they will be public thoroughfares; they are being built, however, not by governments, but by many different companies and individuals, seeking to serve first their own needs, then the needs of others. In this the networks are more like early 19th-century railway systems than they are like roads—though neither analogy does justice to the task that the builders of this new infrastructure face.

The sheer diversity of the networks now being developed makes it hard to see what the finished system will look like. Such foresight is made even harder by the fact that, while data networks and telephone networks are intertwined, data-networkers think of the task of communication in a fundamentally different way from their colleagues in the traditional world of telephones. Both need links between places—wires, fibre-optic cables or radio waves. But the way they use those links differs profoundly and, as yet, irreconcilably.

Pipes and packets

People running telephone networks think of communication in terms of channels and connections. They see their job as creating a channel between two machines, a pipe through which a steady stream of information can flow. To make money, companies charge for a pipe according to its length, the amount of information it can carry (its width) and the time it stays open.

Digital information, though, does not travel in steady streams. It travels in "packets"—more like bits of freight being shipped across country than water flowing through pipes. Think of a message as a large structure—London Bridge, say—that has to be moved from A to B. First it must be broken down into movable pieces. Since all the pieces will be shipped separately—and possibly by different routes—each needs a bill of lading to say what it is and where it should go. The packets sent through a data network also carry such bills, as well as "error-correcting codes" that enable the recipient to see if the data have been damaged in transmission. All this makes things quite complicated—much more so than just letting the data flow down a pipe. But complexity does not matter, as long as there are computers to deal with it and keep it out of sight.

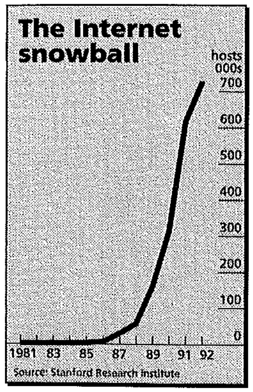
The data networks' hidden complexity gives them great flexibility. The size and shape of a data network are easily changed, more or less at will. Any computer added to the system can help to manage the flow of messages, passing packets on towards their destination by reading their bills of lading. Packets can be sent on their way by whichever route seems best to the computers involved. And they need not arrive in the order they are sent. Networks can be designed so that the receiving computer will take responsibility for reshuffling the packets into order, asking that garbled packets be sent again and generally making up for any deficiencies along the lines.

Systems which can adapt themselves so well to their circumstances do not conform to a single model. The structure of a network is limited only by its technology, its purpose and its history—which is often chequered. Most networks are patchworks, made from available telephone services supplemented by bespoke data-links. Consider a few examples.

Internet is the world's biggest computer network. It links several million people (mostly academics and researchers) around the world through more than 750,000 "hosts". Individual computers are normally linked to a host by small "local-area networks", which use wires owned and operated by universities, companies or whatever. Hosts are linked to each other via long-distance, high-capacity lines leased from telephone companies. Because each host is itself a powerful computer, it can keep con-

[...]at other hosts [...] to and how [...]tions seem to [...]te packets ac- [...]ork manage-ment is distributed between the hosts.

The lack of any centralised management is so complete that nobody really knows how many hosts there are in Internet. Every three months or so, a computer at Stanford Research Institute asks all the hosts that can hear it to speak up and tell Stanford their names. Every time it receives 20-30% more replies than it did the time before. Recently, many of the new voices have come from hosts overseas, and from the companies that are rapidly growing up around the original heart of Internet—which was paid for by governments and available only to officially sanctioned researchers.



America's **United Parcel Service** is putting together a more controlled, less ambitious patchwork called UPSNET to keep track of the 1m or so packages that it picks up and delivers each day. The network already links 1,300 distribution warehouses in 46 countries. By mid-1993 more than 50,000 delivery lorries in America will be linked to it via mobile telephones. Built with the help of four regional cellular-communications companies, at a total cost of around $500m, UPSNET will be America's first national mobile data network.

For the freer of spirit there is **USENET**, an international network linking millions of people without any central guidance at all. USENET provides electronic mail and a series of "newsgroups" where networkers can debate politics, technology, sex or any other common interest. To join the USENET all you need do is to find a member who will forward messages to your machine—and agree to forward mail and news to others.

May your webs always fuse

Governments on both sides of the Atlantic have looked on these networks and seen that they are good. They want to help. America's government has promised to spend a big chunk of the $1 billion it has earmarked for research on "high-performance" computing on expanding Internet into a faster, more far-reaching "National Research and Education Network". The European Commission is talking about an equally ambitious "European Nervous System", linking governments and research establishments.

Grand ideas, unlikely to do much harm. However, data-networking has grown most vigorously from the bottom up, rather than from the top down. Its stimulus was not high-speed data highways, but the local-area networks that companies and laboratories built so workers could share spreadsheets and researchers pool data. The Yankee Group, a Boston firm that watches the market for information technology, estimates that by 1993 four-fifths of America's white-collar workers will use computers linked to local-area networks. The flow of data over these networks, it believes, is growing by about a third each year, and may soon grow faster. Within a year or so, new chips (from Advanced Micro Devices, among others) may bring down the price of the computer hardware that puts data into packets so much that it will be standard on most personal computers, just as it is already on most high-powered workstations.

Larger networks are born when these lesser webs fuse. Vijay Gurbaxani of the University of California at Irvine has studied the way this process gave birth to BITNET, an international network that links local-area networks in universities so that scientists can share results. He found that young networks tend to grow exponentially. With the addition of each new local-area network, the benefits of joining rise because the network provides more people to talk to. At the same time the costs of joining fall. Newcomers are more likely to find a nearby part of the network to connect themselves to. Improved technology and accumulated experience in forging new links also mean that costs fall as networks grow.

There are, of course, limits to this growth. One is the number of people who might want to join; eventually a network serving a community will saturate it, and grow no more. Another is complexity. A network will, at some point, outgrow the technology that manages it. Absorbing new users and smaller networks will increasingly become a struggle, and the cost of expansion will rise inexorably. BITNET has stopped growing at a relatively modest size. Internet, in contrast, is still snow-balling.

The technology to stop networks becoming unmanageably complicated as they grow is already well advanced. But science and engineering will not be enough by themselves. New commercial and regulatory arrangements will be needed to take advantage of ever bigger networks. These are evolving much more slowly.

The seven-fold way

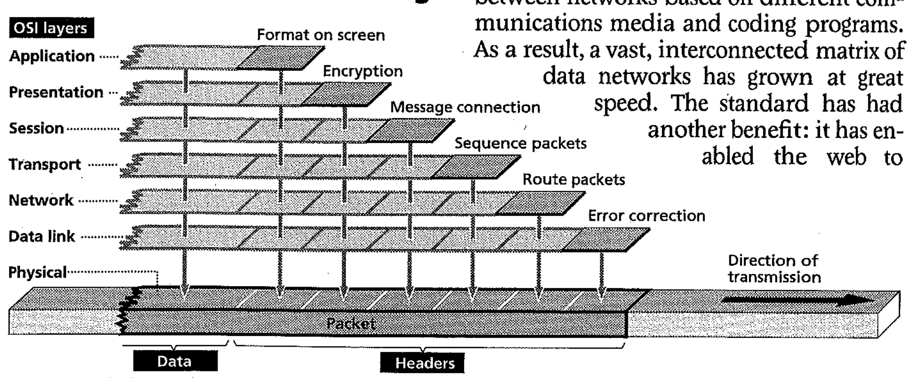
No technology will succeed in the mix-and-match world of network building unless it is governed by accepted standards. At present the design of networks is guided by a sort of meta-standard, the OSI seven-layer model. The OSI model says how data, in their various forms, should look within a network.

At the lowest of the seven levels are standards for sending the 1s and 0s that make up digital data across various media (copper wires, fibre-optic cables, radio waves or whatever). Next are standards that say how those 1s and 0s should look when grouped into packets. At higher levels still are rules about how packets should be assembled into a message. The highest level says how messages should appear on a screen, in the form of paragraphs, pictures and so on. The model is a hierarchy of abstraction: it runs from the nitty-gritty of data on a digital line to the flow of words on a page. What is real to machines is at one end, what is useful to people at the other.

This scheme allows people to disagree about how to do things while agreeing about what to do. A computer will find, stuck on to a travelling packet, tags with the information it needs to deal with the data at each of the seven levels (see diagram). Consider a computer taking a text carried on radio waves and putting it on to a fibre-optic system that works with a completely different sort of packet. The OSI tags let the computer convert the radio-wave dots and dashes into packets, put them in the right order and, going up through the layers, reconstruct the text of the original message. Then, using the second network's methods, it can break the text down into a glimmer of coded light flashing towards some distant machine.

The OSI standard has bridged the gaps between networks based on different communications media and coding programs. As a result, a vast, interconnected matrix of data networks has grown at great speed. The standard has had another benefit: it has enabled the web to

Seven views of the same thing



Headers added at each level of the OSI model specify in ever greater detail how brainstorms can be converted to bits–and back again.

keep pace with advances in communications technology.

The faster data move, the more networks can do. Straightforward transmission of a human voice means sending 60,000 or so bits of data a second. An A4 page of text represents about 100,000 bits of data; a photograph about 10m. A cinema-quality film requires a transmission rate of 20m-100m bits a second. That is the sort of rate at which supercomputers can have meaningful conversations, and the true potential of networking can be realised. Happily, fibre-optic cables (though not much else) can move data around at such frightening rates; making use of such spates, though, has its problems.

The walls come tumbling down

In America, supercomputers linked by the fastest parts of Internet can communicate at a theoretical 45m bits a second. Although inefficiencies mean this rate is not quite reached in practice, the network's speed is already comparable to the 20m-80m bits a second at which data typically move about within a single computer. That allows a strange transformation to take place. When computers talk together on a network at the same speed as the component parts of a single computer talk to each other, the computers start to merge. Computers in such a network find, in effect, that they share in the power of all those to which they are linked.

Scientists talk of using such high-powered networks as "virtual laboratories", in which they can work on horrendously complicated problems with far-flung colleagues as though separated by no more than a laboratory bench and a white coat. Visitors to SIGGRAPH, a computer-graphics conference to be held in Chicago in July, will get a feel for this. The National Centre for Supercomputer Applications at the University of Illinois is going to demonstrate BLANCA, its "gigabit testbed".

BLANCA will link supercomputers in central Illinois to workstations on the convention floor over fibre-optic cable transmitting at about 600m bits a second—just over half a gigabit. From the workstations, visitors will be able to peer about within a computer-simulated thunderstorm, created by weather-modelling software. Or they will be able to poke about inside a three-dimensional model of a dog's heart, animated by supercomputer to beat and move just as it does within the dog's body. Or they will be able to tinker with molecular reactions—again using the supercomputer, this time to make the invisible not only visible but also manipulable—using mathematical models based on quantum mechanics.

Later this decade a new technology called "asynchronous transfer mode" (ATM) may bring such capabilities to a broader audience, which will undoubtedly find more practical uses for it. At the moment, high-speed flows of data are hobbled by slow switches at each end. The faster the flow, the less time each computer in the network is granted to decide where a packet should go. ATM networks allow that decision to be made faster by giving the computer less to think about. Unlike today's packets, which come in a variety of different sizes even within each standard, ATM packets are based on a "cell" of standard length. The computer no longer has to think about where the end of each packet might be, which saves valuable nanoseconds.

In addition to the destination of the data, each packet might contain some indication of their urgency. Thus packets representing parts of a videoconference could be hastened along to ensure a smooth picture, while data being dumped in a spreadsheet

file on someone's desk could be held up for a few milliseconds if communications capacity was in short supply.

Lawrence Roberts, one of the creators of Internet, has founded a company called NetExpress which is building big ATM switches in a partnership with DSC Communications, an American telecoms firm. He hopes to begin selling his wares to telephone companies in about 1995. He reckons that telephone companies might by 2000 or so be offering the public data-networking services capable of transmitting at about the same rate as BLANCA. And ATM can also be applied on more modest scales—even down to that of the individual computer. At the University of Cambridge's Computer Laboratory, among other places, researchers are experimenting with ATM to move data within as well as between computers—though that distinction may not mean much in the high-speed-network future.

More than human

With Mr Roberts and his fellow engineers creating the capacity to flood computers with data, software engineers are trying to stop the poor things from being swamped, and from suffering identity crises. An unprepared computer thrown into a network where data are shared, boundaries blurred and resources likely to be called on by strangers at a moment's notice would be as disconcerted as a hermit dumped in a crowd of telepaths. And not only do the software engineers have to keep the computers sane, they also have to make them simple enough for people to use.

This last job is best done by allowing the user to ignore the network he is using, and to deal with it as if it were a single machine. Such deception depends, in part, on the network file system. This enables computers to peruse data from all over the network as if they were sitting on the computer's own disk drive. Also, "remote-procedure-call" technologies allow a program on one computer to co-operate with another on the other side of the network as if they were running on the same machine. Both techniques enable the computers to know what they are doing to whom, and who is doing what to them, thus keeping things straight.

Networks are tools to let users, as well as machines, communicate. A coming attraction is multimedia mail—electronic mail that contains recorded video and sound as well as text. Sun, maker of the market-leading network file system, is offering this on its new workstations. Apple and Microsoft promise something similar for networks of personal computers soon. It is easy to develop because of the OSI standard, which dictates that a packet carrying text be transmitted exactly like one carrying video. Multimedia messages are just like any other, except bigger.

Networks also allow vast amounts of data to be searched. Brewster Kahne at Thinking Machines, a computer company in Cambridge, Massachusetts, is trying to build a "Wide-Area Information Service". By creating standards for describing the information a particular computer offers, and for queries about that information, it should allow a student to search databases around the world as easily as he could search a computer at his local library. Researchers at CERN in Geneva are trying to build a similar service, which they call World-Wide Web (or w3), drawing on their experience in helping physicists find their way around the mountains of data produced by CERN's accelerators.

Meanwhile other researchers are working on systems that allow one network to find out what another offers. Then they could know the answers to questions that users might ask. Examples: "Does that network have machines that can display video?"; or "Is Marcel Dupont on this network?" One popular approach, led by a consortium of computer companies called the Object Management Group, is to use a fashionable technique called object-oriented programming. The idea is to make everything—every piece of hardware, every program, every definable sub-routine, every cache of data, everything—on the network capable of sending, or responding to, a cer-

tain set of messages. The hard part is to decide what this universally understandable set of messages ought to consist of.

A complementary approach is being developed by a small British company called Architecture Projects Management (under contract to many of the same companies that make up the OMG). It is to build into each network a "trader" that can advertise its capabilities to other networks, and manage its own use of the other networks' similarly advertised services. With such capabilities, networks can form little automated economies, buying and selling disk space, computing power and other services from each other—within limits set by their human masters. Experiments, most notably those at Xerox PARC and Stanford, suggest that such markets may be the best way to manage the explosion of network capabilities.

Trust me

The vision emerging from the research laboratories is one of computers sharing work and data, unhindered by the constraints of space. By co-operating intimately they will provide services none could offer on its own. Back in the real world, however, two practical considerations mar this vision: money and security. People will want to be sure that their machine is sharing its secrets with friends rather than enemies. Those providing data networks will want to be paid for their services—as will, most likely, those whose computers use the networks and thereby end up providing services for others.

Security is an especially frustrating obstacle in the path to network growth. Techniques for so-called public-key cryptography offer relatively easy-to-use ways of creating nearly unbreakable codes to protect data, and nearly unforgeable "digital signatures" to show that a document purporting to come from John Hancock really does. One of the better public-key cryptography techniques has been patented by a small Silicon Valley firm called RSA Data Security and licensed by a host of computer companies such as Sun, Apple, Microsoft and DEC. But America's government, which could do much to establish the necessary standards for data-security technology, seems unwilling to endorse this technology—or any other.

The federal government has repeatedly delayed the choice of a public-key cryptography system for its own use (which would create a *de facto* national standard). It also bans the export of most data-security software and hardware—which means that international networks cannot use systems like RSA. This may stop foreign governments using American technology to put their communications beyond the reach of American spies, but it also prevents multinational companies from using encryption to improve their data networks. Meanwhile, at home, agents from the Federal Bureau of Investigation have been skulking about Congress trying to insert a "right-to-tap" amendment into various communications bills, which would ban criminals from unbreakably encoding evidence of their malfeasance. Where does that leave the fifth amendment?

Confusion over technology, however, pales beside the greater confusion over how to make a business of networking. Most data-workers would agree that their present arrangements with telephone companies are unsatisfactory. The leased lines that provide the long-distance backbones of their services are inflexible and expensive—particularly in Europe, where lack of competition means that leased lines cost up to ten times more than they do America. Worse, because data traffic is so "bursty", data-networkers have to support leased lines that work, on average, at only 1-3% of capacity.

Data-networkers would like to buy more suitable services from the telephone companies. Telephone companies, tied to the traditions of voice service, have failed, by and large, to offer those services. There are some encouraging signs of innovation, especially in America. US West, a regional telecom company, is conducting an experiment in which firms create local-area networks by plugging computers into wall-sockets owned and operated by US West rather than buying their own equipment. Other companies are offering new services to carry data in bulk more cheaply and flexibly; one such is ISDN (integrated services digital networks), which provides digital lines capable of transmitting up to 2m bits a second. It is still expensive and often unavailable, though, and its speed, now impressive, could seem a bit sluggish by the time it becomes widespread.

It is on the basis of such services that American telephone companies think they can increase the money their data-networking services earn, from $4 billion a year today (10% of their total business) to as much as $40 billion a year (50% of the total business) in ten years' time. That growth will precipitate wide-ranging regulatory change. In America and elsewhere, telephones and cable television are kept well apart. Videoconferencing, multimedia mail and the like fit into the gap between them. Are telephone companies really to be allowed to carry television for IBM and GM, but not for NBC and CBS?

More puzzling than who does it, though, is how to pay for it. Today's pricing schemes, which concentrate on connections and time, are ill-fitted to data networks. Data move about all the time, but some need to be kept flowing more than others. Helmut and Fatima's video-conference packets are more time-sensitive than the e-mail going from Carol to Nguyen. Should pricing be based on the number of packets, or on the number of packets plus some measure of speed and quality of service, or on something else?

Such commercial details may well determine the future of the world's communications system. But they are unlikely to cramp its growth unduly. One reason is that the technology already exists to create wonders. These wonders are in demand, so someone will find a way to make the technology pay. Another is that networks are, first and foremost, flexible. They can adapt themselves to any environment, even the worst that unco-operative companies and tardy regulators can provide. It may take time, but one day the computers of the world will unite. ■

Politically correct patrons

NEW YORK

THIS autumn the Wexner Centre for the Arts in Columbus, Ohio, will display commissioned works by six "artists of colour . . . who challenge individual and societal power and question the 'truth' of written history." Next summer, at the Studio Museum in Harlem, "Artists Respond: The 'New World' Question" presents the reflections of black American artists on the legacy of 1492 (ie, Columbus and all that).

"So what?" will be the reaction of anybody who has visited the many contemporary art galleries that have proliferated around America. The shrill, didactic tone of these shows is by now commonplace. What might cause more surprise is the news that these two exhibitions are among ten similarly conceived museum shows being sponsored by one of America's largest companies, American Telephone & Telegraph. Under a programme called "New Art/New Visions", AT&T has selected ten shows of work primarily by women and "artists of colour" and provided financial aid for galleries to show and eventually to purchase that art. AT&T says this reflects its commitment to contemporary artists who find it hard to get their work into galleries.

Basquiat's doodles

Other firms are similarly engaged. For some big businesses, it seems, the popping of champagne corks at blockbuster exhibitions has given way to a show of concern for blacks, women and other "minorities". These are the same groups whose plight and art (often one and the same, some maintain) have been shown in dozens of thematic exhibitions all over the United States.

Some observers of philanthropic trends see this outburst of caring as just another swing of the pendulum of sentiment, similar to the swing in the late 1960s, the last time when conspicuous wealth was out of fashion. But AT&T's support for "New Art/New Visions" is not a simple case of philanthropy. By the company's own admission, it is also aiming at customers for the firm. Blacks and women, an AT&T spokesman says, buy a growing portion of the firm's services. Philip Morris, Metropolitan Life Insurance and Ford have echoed that message in their own arts funding. Time-Warner is backing "Songs of My People", an exhibition of photographs by about 30 black American photographers that is set to go to 23 American cities between now and 1994.

This sort of marketing campaign is not entirely new. "Cause-related marketing" is corporate-speak for a concept American Express pioneered a decade ago. American Express found it could get more people to use its plastic cards more often if a small percentage of billings was siphoned off to help a regional symphony orchestra or dance company. This approach was subsequently promoted by the Business Committee for the Arts, a group set up by David Rockefeller which now helps around 120 companies to pursue their business interests while financing everything from public television to operas, plays and classical concerts.

Art galleries seeking corporate support make a powerful pitch. For the same sum it takes to buy advertising side-by-side with dozens of other businesses, they say, a company sponsoring an exhibition can gain exclusive exposure for itself, and do so in attractive places where executives can also entertain clients.

The socially conscious twist of supporting the arts also makes business sense, claims James Abruzzo of A.T. Kearney, a management consultancy which advises arts organisations how to market themselves. At a time of economic recession, Mr Abruzzo says, some chief executives want to avoid being associated with big international exhibitions and "effete" high art.

Historically, art by women and blacks has been missing from American art galleries. But some critics question whether the AT&T approach is the best way to include such excluded artists. Critics also worry that AT&T's multicultural guidelines will influence exhibition planning nationally and persuade too many art dealers to show similar works, turning apolitical artists into the new out crowd.

AT&T claims to disregard the critics, in a spirit of openness to new work. Only "divisive art" is off limits. According to Tim McClimon, the AT&T Foundation's visual-art specialist, the firm wants to be connected with the changing "ethnically diverse landscape" of its consumer and employee bases. "Any corporation that is not tuned in to the issues of diversity today is probably not going to be around tomorrow."

Diversity, however, has its risks, and has sometimes backfired. An AT&T-sponsored production of "King Lear", which reversed the sexes of Shakespeare's characters, caused a mutiny within the company's ranks. Philip Morris, which is renowned for its own risk-taking in arts projects, has raised a storm by backing an exhibition in New York that examines the shared history of blacks and Jews in America.

So far at least, AT&T has shown no signs of being deflected by criticism of its approach. It has put up $100,000 to sponsor a retrospective exhibition of the art of Jean-Michel Basquiat, a black protégé of Andy Warhol whose art was inspired by the graffiti scribbled on walls and subways. AT&T proudly claims the Basquiat show will be the first retrospective of a black American artist to be mounted at the Whitney Museum of American Art, a New York institu-

Gays come out

NEW YORK

FILMS by and about homosexuals are enjoying broader mainstream success in the United States than ever before. "My Own Private Idaho" and "Paris is Burning" were among the box-office hits in 1991. In 1992 it looks like being the turn of the gay and lesbian press to make a bigger splash in the mainstream.

The launch on June 15th of *Out* magazine, which bills itself as America's first general-interest magazine for gays and lesbians, is just the latest of several new and revamped up-scale publications in the genre. It is a glossy "lifestyle" magazine—lots of book, screen and stage reviews, slick fashion and travel features, and lengthy personality profiles.

Out's editor-in-chief, Michael Goff, says he wants to win best-magazine-of-the-year awards, not those for best alternative magazine. His task is difficult on two scores. First, unlike *Genre*, a year-old lookalike, and *QW*, a new New York weekly, *Out* is for both male homosexual and lesbian readers. That will make for a difficult editorial balancing act. Second, the gay and lesbian press still has to break into the advertising mainstream.

Magazine and newspaper readers among America's 25m or so homosexuals are well above average earners, travellers and spenders. Yet their magazines have not attracted the big consumer advertisers. Businesses are put off by explicit sexual advertisements and pictures. *Out* seeks to break out of this box by declining to carry either telephone sex advertisements or explicitly sexual photographs. *Genre* has banned classified sex advertisements. The *Advocate*, a twice-weekly national newspaper, has got around the problem by gathering such advertisements into a folded insert.

Like the gay and lesbian cinema, these publications need to decide how to get themselves accepted by mainstream audiences. Are they just looking for the gay and lesbian angle to the subjects covered by all general-interest magazines? Or are they concentrating on homosexual issues, such as AIDS, gay-bashing and the pros and cons of exposing closet homosexuals?

There is no easy answer for publishers or, indeed, for film makers. For all its changes, the *Advocate* remains as committed as ever to the cause of equal rights for homosexuals that it always championed. *Out* is starting off as apolitical as any gay and lesbian publication can be. Perhaps the homosexual world is sufficiently heterogeneous for both to prosper.

tion frequently criticised for its pursuit of ideological soundness (or political correctness) and its retreat from anything resembling traditional curatorial standards.

Not everybody on Madison Avenue is convinced that AT&T is doing itself a good turn. In today's search for family values and role models "of colour", does a large blue-chip corporation really want to be identified with a graffiti painter like Basquiat who ran away from home at 17 for a life of sexual promiscuity, Warhol parties, profligacy and death from a heroin overdose at the age of 27? "If we didn't feel we were enhancing our image, we probably wouldn't be doing it," says an AT&T spokesman.

Greek sculpture

The age-old question

ATHENS

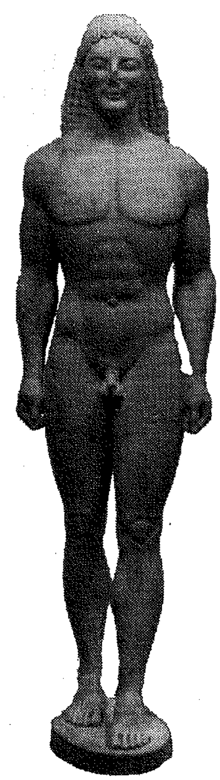
IT WAS the kind of sculpture a curator of Greek antiquities dreams of acquiring: a larger than life-size marble *kouros*—a nude figure of a young man—that was almost flawless. But, as the provenance was unclear, the J. Paul Getty Museum in Malibu, California, decided to run a series of scientific tests to determine if it was authentic. Convinced by the results, the museum forked out $10m for the piece.

That was in 1985. Since then more and more scholars have expressed doubts about the authenticity of the Getty *kouros*. In 1990 it was removed from display. This summer it is being exhibited at the N.P. Goulandris Museum of Cycladic Art in Athens, after being pored over and discussed by a dozen scientists and 80 other experts on early Greek sculpture.

Their colloquium was held behind closed doors and no conclusions were announced. According to staff at the Getty museum, a verdict is still awaited. Some at the meeting other participants were blunter. They disclosed that about three-quarters of those present at the colloquium believed that the *kouros* was a fake. Some even suggested its probable sculptor: a renowned Italian producer of fakes, nicknamed Il Professore for his knowledge of ancient art.

The Getty *kouros* is said to have come from a private collection in Switzerland. Suspicion about its authenticity was aroused when the documents accompanying it were found to be forged. As a distinguished curator from another American museum put it: "The moral is, never ever buy a piece without a provenance."

Even a fragmentary *kouros* is rarely found in a saleroom, let alone a complete figure. Among the earliest Greek statues, they were mostly made around 600 BC—the Archaic period of Greek art—in workshops near Athens and on the Aegean islands. About 140 *kouroi* are known to have survived. They were too large to be easily carried off by early collectors of Greek antiquities and were, anyway, dismissed as primitive by comparison with classical Greek art.



True or false?

The most plausible evidence that the Getty *kouros* might be genuine emerged from tests in laboratories. These established that it was carved in dolomitic marble from the north Aegean island of Thassos, where a colossal unfinished *kouros* can still be seen in a quarry. Ultra-violet photographs showed a varied, pitted surface, unlike that of a fresh-cut sculpture. Closer examination under high-powered magnification revealed weathering consistent with the patina that a statue acquires over the centuries. Forgers soak their work in acid to create the same effect, but such forgeries can now be easily detected.

Connoisseurs at the colloquium were not convinced and raised some awkward points. The statue's stylised hair belongs with the earliest *kouroi*, dating from before 600 BC. But its naturalistic feet resemble pieces a century or more younger. The muscular thighs have much in common with *kouroi* from Corinth, but the oval plinth recalls a statue from Boeotia in central Greece.

The doubts of the connoisseurs were reinforced by archaeologists and by sculptors who have helped to restore statues. A *kouros*, they said, was usually joined to its plinth with lead clamps, and the plinth was usually cut away at the sides to fit into a marble base. Yet no trace of lead appears on the Getty *kouros* and its plinth slopes outwards. Faults in the *kouros* increased their doubts. An ancient statue breaks where the marble

is weakest, at the neck, wrists or ankles. But the Getty *kouros* has a suspicious-looking break at the shoulder. It lacks the pick-marks invariably found on pieces from illicit excavations where digging is hastily done.

These doubts probably mean that the Getty museum will be able to hang on to the *kouros* if it wants to. Were it proven a genuine piece, the Greek government would immediately claim back its stolen property. ■

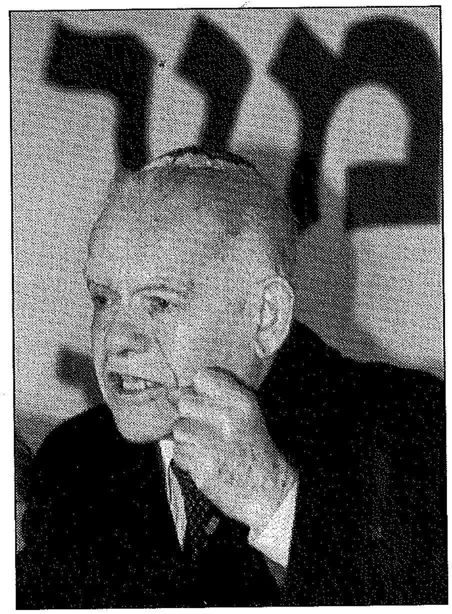
Israeli politics

Unholy rows

THE FALL OF ISRAEL. By Barry Chamish. *Canongate Publishers; 314 pages; £15.95*

GIVEN its Lilliputian dimensions, Israel may be the most over-reported country in the world. It is also a place outsiders have a hard time understanding. One reason has to do with the behaviour of foreign correspondents. They and their editors back home are interested in Israel chiefly because it represents 50% of the Arab-Israeli conflict, which from time to time generates dramatic wars. Comparatively little attention is paid to Israel as a society in its own right. This book is a flawed but nonetheless interesting attempt to redress the balance.

Barry Chamish describes himself as an Israeli patriot and war veteran, with no intention of adding to the "long and ignorant series of Israel bashing by enemies of that country". He makes no apology for, and appears to support, Israel's position vis-à-vis the Arabs. Yet his book is a ferocious assault on Israel; not for its foreign policy but for its internal corruption and incompetence. The Israeli people, he says, are decent and caring but exploited by venal politicians and bureaucrats. As a result, those who can afford it are fleeing the country in droves: he reckons that some 700,000 Israelis have emigrated permanently.



Shamir blocks reform

Much of the venality, Mr Chamish argues, springs from Israel's ludicrous version of proportional representation. The fate of governments depends on luring tiny political parties, or even individual members of parliament, into finely balanced coalitions. This presents juicy opportunities for political extortion. Israel's interior minister, for example, is under police investigation on suspicion of misappropriating public funds. A self-confident government might try to get rid of him, particularly on the eve of an election. But the small religious party to which the minister belongs may be vital to a Likud government when it comes to building a post-election coalition. So the minister stays on.

Although the political system Israel has chosen for itself has many other baleful attributes, this book makes no really systematic attempt to dissect them. What it offers instead is an opinionated and sometimes outrageous whirl through a rogues' gallery of unsavoury politicians, together with potted histories of the more egregious scandals to have rocked the country in recent years. No area of public life—not even the revered armed forces—emerges without taint.

Here is a sampling of the author's offerings on the military front. Rami Dotan, the chief equipment officer of the Israeli air force, embezzled $12m from his employers. Because Shin Bet, the internal secret service, ignored clear evidence of the unreliability of Mordechai Vanunu, a technician at the Dimona nuclear plant, Mr Vanunu was able to splash Dimona's secrets all over the London *Sunday Times*. Many of the gas masks distributed during the Gulf war were defective. In numerous clashes in recent years, Israeli soldiers have reacted with confusion or cowardice to Arab raids and ambushes. And so on, in similar vein.

The author's list of failures on the civilian front is even longer. Israel has failed, through bumbling and bureaucracy, to ease the absorption of immigrants from Ethiopia and the Soviet Union. Its banks have come close to collapse. The *kibbutzim* (collective farms) are expensively pampered flops. Shimon Peres, the former leader of the Labour Party, is taken to task for constant scheming against the "national unity" government of which he was himself a member. Yitzhak Shamir, of the rival Likud Party, is accused of blocking an overwhelming public desire for political reform. Other targets include David Levy, the (not properly educated) foreign minister, Yitzhak Rabin, the (too old) Labour Party leader and Ariel Sharon, the (incompetent and bullying) housing minister.

If Mr Chamish's aim was to prove that Israel is in a mess, he succeeds well enough. But an unselective catalogue of Things That Have Gone Wrong could be culled from the newspapers of any country where the press is reasonably free. To the difficult questions—why and whether Israel runs its affairs less capably than other places—he has few persuasive answers. His method is like that of Soviet journalists who reported from the capitalist world before the collapse of communism. They sent home solemn tales about how the police framed and imprisoned innocent people with the connivance of the courts, about homeless people forced by callous governments to live in cardboard boxes and about the corrupt behaviour of miscellaneous fat cats.

None of these stories was untrue in detail; only when dressed up as a balanced account of life under capitalism did they add up to a falsehood. Mr Chamish's Israel is a similar caricature. But it is also a timely reminder that, when Israelis go to vote, the fate of the Arab-Israeli "peace process" may, contrary to the assumption of outsiders, be the last thing on their minds. ■

Correction
Last week we said that the author of "The Lost Country" was Peter Becker, instead of Jasper Becker. Sorry.

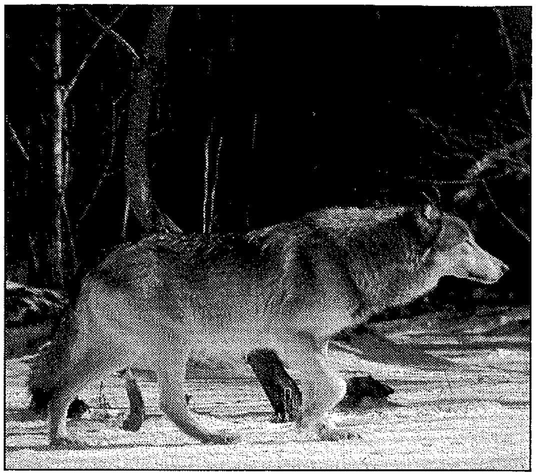
National Parks

Cry wolf!

THE NINEMILE WOLVES. By Rick Bass. *Clark City Press; 166 pages, $22.95*

MONTANA is a place with one pre-eminent political issue—wildlife—and two irreconcilable tribes. The state contains a large and growing population of neo-Thoreauist, back-to-nature writers and artists, fleeing from the megurbs, but they are still outnumbered by pick-up-driving, big-bellied, trigger-happy ranchers and hunters, as unsentimental as any people on earth. Between these two groups has come a symbol of their disagreements: the wolf.

Wolves have been fitfully colonising the state from Canada in recent years, trickling south towards the shrine of Yellowstone national park, whose ecological imbalance—far too many elk—can be redressed only by a pack or two of hungry canines. The federal government, uncertain that the wolves will make it on their own, wants to introduce them to Yellowstone. The pick-up fraternity



Hungry for beef steak?

and their representatives at state level are doing their utmost not only to prevent this but also to trap existing wolves and move them to the sanctuary of Glacier national park, on the Canadian border, whenever the wolves get too close to cattle.

Even though it is a surprising and welcome fact that wolves reared on deer meat will often eschew cattle, the ranchers and hunters have a point. Man has brutally usurped the wolf as the predator of hooved animals, and is unwilling to relinquish the role, as he would have to. "No wolves no where no way", says the local congressman. "Say no to wolves", says the Common Man Institute. To be pro-wolf in Montana is to be ex-urban, eastern and over-educated.

This book is about one ill-fated black she-wolf and the two litters she gave birth to in 1989 and 1990. It would spoil the story to say more. Rick Bass stands in a tradition of western nature-writing that is reminiscent of the one that flourished in British India. But, instead of following *shikaris* after tigresses into *nallahs*, where "it was quiet, too damn quiet" and the suspense is spoiled only by the knowledge that the author survived to write the tale, the reader follows people called Ed and Craig with radio-tracking equipment along creeks with names like Big Bear, where the very trees weigh heavily with metaphors for man's unworthy place in the ecosystem. Mr Bass is not the best of this school. He is not as thorough as John McPhee, nor as mystical as Peter Matthiesson, nor as polemical as Edward Abbey. But he has provided an intriguing glimpse of the battle of man against man over the wolf.

Big Momma

Novel of the Month

THE routines of a tightly knit Irish-American family as experienced by three children provide the structure of this novel* by Alice McDermott. For instance, they and their mother Lucy regularly visit the Brooklyn apartment of their great-aunt known as "Momma": an apartment where their mother's three unmarried sisters, May, Agnes and Veronica, also live. May is sweet, giving them treats and taking them on little expeditions; Agnes is elegant but is also kind; and Veronica is a gentle alcoholic. But it is Momma who dominates the apartment, the four sisters, and the children's imagination. She is a white-haired, black-eyed old lady who sits in an upholstered chair close to the dining-room table, and makes clear how angry she is "at the fates".

It slowly becomes apparent that this particular tightly knit family has been irretrievably maimed by two calamities: the death many years before of Momma's sister, the mother of the four now 40-ish women, and then by the death a few months later of their father, whom Momma had meanwhile married and become pregnant by. The reader gradually comes to comprehend the power of this elderly woman; or more precisely, the power of what she so unyieldingly believes: that her life was impossibly unfair and no one should forget it.

As a counter to the raging matriarch and her never-to-be forgotten griefs is the story of the successful courtship of May by a local (Irish) postman. Although their marriage ends in tragedy, their delight in each other offers some kind of solace. Another bright thread is the children's own family life, especially when their father is in command: driving them home after a long, often acrimonious day at Momma's, or on their two-week summer holidays.

In a sense this novel is simply about the pluses and minuses of growing up in an emotionally overheated family. The children are squeezed by their relatives' lives but they are also held in them as well and made to feel safe. The Irish-American subculture is seen sympathetically but without sentimentality.

The author never lets Momma become merely a tiresomely self-pitying and destructive old lady. She has a kind of grandeur about her, which she lends to all the lives that touch upon hers, as if she were a witness to all the pain in the universe, not just her own. And May's sweetness, and her postman's love for her, the children's for their father and his love for them, and for the whole of his wife's family of women, appear also to possess symbolic weight, as the only conceivable antidote to such sadness.

* "At Weddings and Wakes". Farrar, Straus & Giroux; 213 pages; $19

Publishing

A writer's friend

AUTHOR AND AGENT. By Michael Kreyling. *Bellew Publishing; 216 pages; £13.95. Farrar, Straus and Giroux; $24.95*

WHEN Emily Brontë had completed "Wuthering Heights", she searched for a publisher. After numerous rejections, she found one willing to produce 300 copies of the book on payment of £50 (now worth $3,200) towards printing costs, this to be returned to her if sufficient copies were sold. Little in publishing has changed since then, whatever the book business claims. Publishers still overlook books of merit. They still seek to treat their authors meanly.

Eudora Welty is a kind of more modern Emily Brontë. She lives in Jackson, Mississipi, as remote from the publishing world of New York as the Brontë sisters' Yorkshire was from London. Her stories of life in the American South were rejected by publishers with bleak consistency. But she had a bit of luck. Her talent was spotted by a literary agent, Diarmuid Russell, who gave her encouragement, won recognition for her and eventually money.

Agents are disliked in the book business. Publishers are nasty about them because they ask for money. Authors fear that if they take on an agent, he (or she: there are lots of women agents) may turn out to be an extra nincompoop in the way of publishing. There have not been many books praising agents. That is the interest of this one. Russell does appear to have been special, patiently persuading his reticent, unconfident and gifted client to produce work that might otherwise never have been written. This account of their relationship is a treasure.

It is also a sad book. When Russell died in 1973, publishing was becoming increasingly aggressive. "We sell books, other people sell shoes—what's the difference?" said Michael Korda, one of the new men in publishing. The difference for Russell was that books were not just products: they were vital to civilised life. Eudora Welty felt that. So would have Emily Brontë.

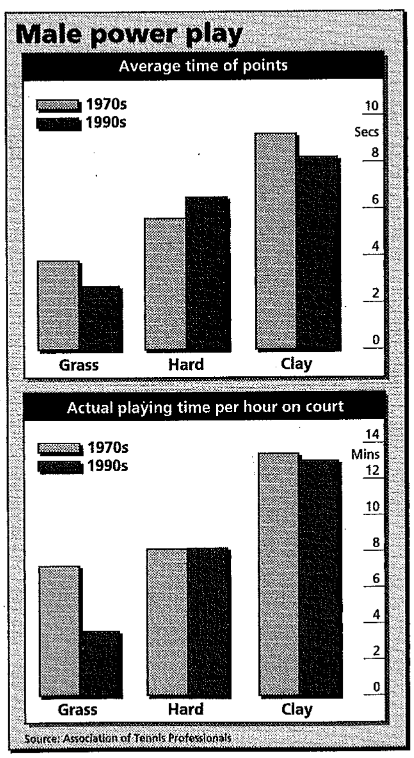
Service charge

Ever bigger men hitting the ball ever harder are overwhelming graceful players in professional tennis tournaments played on grass

TAKE a safe bet on this year's Wimbledon. Michael Chang, the world's sixth-best tennis player, will not reach the men's final, nor even the semi-finals; Marc Rosset, 40th in the world, just might. The reason? Mr Rosset, a 21-year-old Swiss, is 6ft 5in (two metres) tall and can serve a tennis ball at 134 miles per hour. Mr Chang, a 20-year-old American, is 5ft 8in tall and struggles to serve harder than 95 miles per hour. On Wimbledon's grass—slick and fast in the tournament's first week, dry and faster in the second—victory will go to the player with power.

That may be what everyone wants, for the moment. Wimbledon's uncomfortable seats remain a tout's delight; the players acknowledge the tournament as the one they most want to win. The Centre Court final, say the marketing men, is gladiatoral combat at its best: serve, return, volley—until the player with the greater power and the stronger nerve takes the winner's cheque.

But does the product really match the spiel? Great tennis matches are struggles of mental power, skill and tactics. One Wimbledon semi-final in 1977 stretched Bjorn Borg against Vitas Gerulaitis over five sets of baseline passes, scintillating volleys, topspin lobs. Compare that with one of last year's semi-finals: poor Stefan Edberg won all his service games—and was still beaten, on the luck of the tie-breaks, by Michael Stich, a then little-known German who serves at 128 miles per hour. When Mr Stich beat his big-serving compatriot, Boris Becker, in the final, the typical point lasted 2.5 seconds and consisted of just three strokes. An hour of Wimbledon's grass-court tennis now produces less than four minutes of the ball in actual play. By contrast, the slow clay of the French Open gives 13 minutes, and the hard courts of the American and Australian Opens eight minutes.

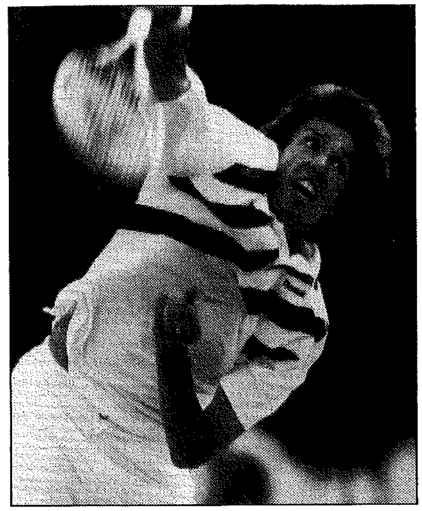


Clearly the comparison reflects the differing natures of different surfaces. Clay-court tennis, with the fastest ball slowed by clinging dust, produces baseline rallies that would tax Job. What is worrying, however, is the comparison over the years: clay-court and hard-court tennis produce the same amount of actual playing per hour as they did 20 years ago. Playing-time on grass courts, however, has fallen by almost half. The Wimbledon fan is literally getting less for his money.

Part of the reason is physical: big men have the power to win points faster. In 1973, when the Association of Tennis Professionals began its rankings, only four of the top ten were 6ft or more tall. Today there are nine six-footers in the top ten, with Michael Chang the tiny exception.

But the greater part of the explanation is technological. Until the late 1970s the top men professionals—apart from the young Jimmy Connors, who wielded a strange new steel-framed racket called the Wilson T2000—used wooden rackets. There were big men with big serves, such as Roscoe Tanner and Stan Smith, but there were plenty of smaller men—Rod Laver, Ken Rosewall, Manuel Orantes—who won with artistry, not power.

Would that they still could. Big became best after Howard Head introduced the oversized Prince racket in 1976 by using the technology of fibreglass skis. Now all players use rackets made by moulding together graphite fibres and exotic materials such as Kevlar and boron. Because they are stiffer than wooden rackets, they bend back less when they hit the ball—which means they transfer more energy to the ball. True, the rackets lack the "touch" that came with wood, but the ball goes so hard that touch is almost irrelevant. Even the mediocre player can now hit topspin backhands like Rod Laver—and from angles impossible with a wooden racket.



Dynamite Stich

The first implication is that, if good "touch" hardly exists, what matters is power—so the bigger the player the better. The second implication is that improved rackets will make players even more powerful. Add such thoughts together, and perhaps tennis, especially grass-court tennis, will become such a boring trial of big serves and occasional returns that nobody will bother to watch.

Alarmist? Maybe, but the professionals' own association is worried enough that in March it held a seminar to discuss possible safeguards: ban the second serve; keep one foot on the ground during the serve; use slower balls; make slower surfaces; make the serve go into a smaller area. Best of all, some argue, take a leaf from golf, cricket and baseball and regulate the equipment, by setting standards for racket stiffness and size (some now have head sizes of up to 130 square inches, compared with the wooden rackets' 78). After all, the authorities were quick enough in the late 1970s to ban "spaghetti" stringing patterns because of the outrageous spin they fostered.

But any brake on technology has to be chosen with care. The truth is that modern rackets have been tennis's godsend: light enough for children to play tennis easily; stiff enough to have taken women's tennis far away from its old pat-a-cake boredom. Their "sweet spots" are large enough to let even a cross-eyed pensioner hit a winning volley. Those virtues explain why so many people play tennis—more than 20m in America alone. Mr Connors says the new rackets have "probably ruined" the men's singles at Wimbledon. Since he reached the third round last year at the age of 38, he is surely exaggerating. On the other hand, if young Mr Rosset does win this year, perhaps not . . .

Southeast Banking Corporation
and Subsidiaries

WILLIAM A. BRANDT, JR.

As the Chapter 7 Trustee in the matter of SOUTHEAST BANKING CORPORATION, now pending as Case No. 91-14561-BKC-SMW in the United States Bankruptcy Court for the Southern District of Florida, the Honorable Sidney M. Weaver, Chief Judge, presiding, offers:

FOR SALE

VENTURE CAPITAL FUNDS

SOUTHEAST BANKING CORPORATION holds a ninety-eight percent (98%) limited partnership interest in SOUTHEAST VENTURE CAPITAL I ("SVCI") and SOUTHEAST VENTURE CAPITAL II ("SVCII"). These funds were established to provide start-up and early-stage financing to high growth companies. The funds currently hold common stock, preferred stock, warrants, and notes in fifteen (15) separate companies, the majority of which are located in Florida.

On 15 June 1992, pursuant to an Order of the Bankruptcy Court, the Trustee entered into an Agreement For The Sale of Limited Partnership Interests with a proposed purchaser. The Bankruptcy Court Order that approved the Trustee's acceptance of this proposed purchase offer also established the procedures to be employed for the sale of SOUTHEAST BANKING CORPORATION'S limited partnership interests in SVCI and SVCII. The purchase price set forth in this Agreement is $2,800,000. This amount is subject to competitive bidding by any other interested parties, provided that any such other bids must be on the same terms and conditions as are contained within the Agreement approved by the Bankruptcy Court. All other potential bidders will be required to complete their due diligence procedures and submit competing offers, including the posting of an earnest money deposit of $250,000, by 27 July 1992. In the event that qualified competing offers are received, the Bankruptcy Court will hold a hearing on 04 August 1992 to approve a sale to the highest bidder.

Development Specialists, Inc., a reorganization and management consulting firm which is presently directing the liquidation of SOUTHEAST BANKING CORPORATION under the direction of the Trustee, will be conducting all aspects of the sale process. Parties who are interested in reviewing the existing proposed purchase offer, obtaining additional information regarding the funds, and submitting a competitive bid are urged to contact either Mr. Patrick J. O'Malley or Mr. Joseph J. Luzinski at the Miami offices of Development Specialists, Inc.

DSI Development Specialists, Inc.

Three First National Plaza,
70 West Madison Street,
Suite 2300,
Chicago, Illinois 60602
Phone: 312/263-4141
Fax: 312/263-1180

The Miami Center Building,
201 South Biscayne Boulevard,
Thirty-Second Floor,
Miami, Florida 33131
Phone: 305/374-2717
Fax: 305/374-2718

Devonshire House,
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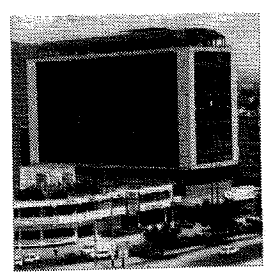

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DEPUTY VICE-CHANCELLOR (RESEARCH)

(Ref. 1094)

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PROFESSORSHIP OF ACCOUNTANCY

(Ref: 67/92)

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Information and application materials may be obtained directly from:

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Faculty of Economics and Commerce

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Further particulars are available from D.W. Girvan, Registrar, P.O. Box 56, Dunedin, New Zealand (telephone (64)(3)479-8250 or facsimile (64)(3)474-1607) and include details of the method of application. (Applications will close on 31 July 1992).

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If you are interested you should contact the Australian higher education institution where you wish to study. When you apply you should notify them of your interest in this program. The institution will send you the appropriate application form. The closing date for applications will be set by the individual institutions, most will be during September and October 1992, although some may be earlier.

If you wish to know more about the higher education institutions and their courses you can contact either your nearest Australian Diplomatic Mission or Australian Education Centre. Australian Education Centres are located in:
Bangkok, Hong Kong, Jakarta, Kuala Lumpur, Manila, Seoul, Singapore, Suva, Taipei.

ECONOMIC AND FINANCIAL INDICATORS 1

OUTPUT, DEMAND AND JOBS Japan recently switched from GNP to GDP when reporting its national income. Its GDP (shown in the table) rose 2.2% in the year to the first quarter; its GNP, however, rose by 3.5%. America's industrial output rose for the fourth consecutive month in May, leaving it 2.3% higher than in May 1991. Britain's industrial production rose by 1.4% in the year to April—the first year-on-year increase since June 1990. Britain's retail sales grew by 2.1% in the year to May. Australia's jobless rate climbed to 10.6% in May.

% change at annual rate

	industrial production		GNP/GDP		retail sales [volume]		unemployment % rate	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year	latest	year ago
Australia	− 7.2	+ 3.8 Apr	+ 2.4**	+ 0.8** Q1	− 3.0	+ 1.0 Q4	10.6 May	9.4
Belgium	− 1.5	− 2.2 Jan	na	+ 1.6 1991	+22.3	+15.5 Feb	8.9 Apr	8.2
Canada	− 1.9	+ 1.3 Mar	− 0.8	− 0.2 Q4	− 2.0	− 0.1 Mar	11.2 May	10.2
France	+ 0.6	+ 2.5 Mar	+ 4.5	+ 2.9 Q1	− 1.5	+ 2.7 Apr	10.0 Apr	9.2
Germany††	+ 9.0	+ 0.7 Apr	+ 7.3	+ 0.8 Q1	+ 6.2	− 6.1 Mar	6.5 May	6.3
Holland	− 4.0	+ 6.0 Mar	+ 4.5	+ 3.4 Q1	+ 4.9	− 0.1 Feb‡	4.4 Apr	4.6
Italy	+ 4.5	− 0.5 Mar	+ 1.2	+ 1.5 Q4	+44.7	− 2.6 Sep‡	10.9 Apr	10.1
Japan	−11.8	− 5.5 Apr	+ 3.4	+ 2.2 Q1	+ 3.8	+ 2.1 Feb	2.0 Apr	2.1
Spain	− 3.1	+ 9.7 Mar	+ 2.4	+ 2.3 Q1	− 1.7	− 0.9 Apr‡	14.7 May*	15.2
Sweden	+ 8.3	− 9.7 Mar	− 1.3	− 0.5 Q4	+ 1.3	− 3.5 Mar	4.2 Apr*	2.1
Switzerland	+ 3.4	+ 3.5 Q4	− 0.9	− 0.5 Q1	−16.8	−10.9 Mar‡	2.7 May*	1.1
UK	+ 0.5	+ 1.4 Apr	− 2.5	− 1.6 Q1	nil	+ 2.1 May	9.5 Apr	7.7
USA	+ 4.3	+ 2.3 May	+ 2.4	+ 1.5 Q1	+ 9.0	+ 3.2 Apr	7.5 May	6.8

‡Value index deflated by CPI. † Average of latest 3 months compared with average of previous 3 months, at annual rate. **New series

PRICES AND WAGES America's consumer-price inflation slowed to 3.0% in the 12 months to May; its wholesale-price inflation quickened to 1.1%. Britain's annual rate of consumer-price inflation remained at 4.3% in the year to May. In the same period, inflation in France and Spain was also unchanged, at 3.1% and 6.5%, respectively; but Sweden's inflation rate slowed, to 2.2%. Italian wages rose by 8.8% in the year to April, a 2.9% increase in real terms.

% change at annual rate

	consumer prices*		wholesale prices*		wages/earnings‡	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year
Australia	nil	+ 1.7 Mar	− 0.4	+ 1.0 May	+ 6.7	+ 2.5 Feb*
Belgium	+ 2.1	+ 2.8 May	− 2.4	+ 1.2 Mar	− 9.1	+ 4.1 Q1*
Canada	+ 1.9	+ 1.7 Apr	+ 3.3	− 1.1 Apr	+ 6.5	+ 3.9 Mar
France	+ 3.2	+ 3.1 May	+ 0.4	− 3.1 Q1	+ 3.2	+ 4.1 Jan*
Germany††	+ 4.8	+ 4.6 May	+ 1.8	+ 1.9 Apr	+ 4.4	+ 5.4 Mar
Holland	+ 4.1	+ 4.2 May	+ 2.1	+ 2.6 Apr	+ 4.1	+ 3.0 Apr
Italy	+ 5.3	+ 5.7 May	+ 0.1	+ 1.6 May	+ 3.0	+ 8.8 Apr*
Japan	+ 1.2	+ 2.4 Apr	− 0.3	− 1.2 Apr	− 2.9	+ 2.2 Mar
Spain	+ 5.7	+ 6.5 May	+ 1.9	+ 1.5 Apr	+ 7.5	+ 8.5 Q4
Sweden	+ 2.3	+ 2.2 May	− 1.2	− 1.1 Apr	+ 0.3	+ 2.8 Mar
Switzerland	+ 4.5	+ 4.2 May	+ 0.8	+ 0.6 Apr	na	na
UK	+ 7.3	+ 4.3 May	+ 6.2	+ 3.6 May	+10.0	+ 7.5 Mar
USA	+ 3.8	+ 3.0 May	+ 2.0	+ 1.1 May	+ 2.3	+ 2.5 May

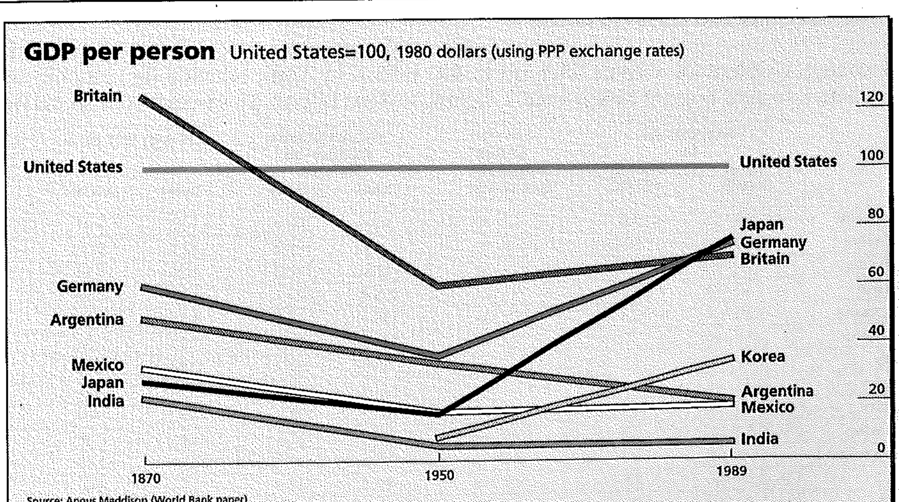
‡ Hourly earnings for all employees except Australia, weekly earnings; Belgium, Sweden, industrial hourly earnings; Canada, manufacturing hourly earnings; Holland, hourly wage rates; Italy, manufacturing hourly wage rates; Japan, Switzerland, manufacturing monthly earnings; Spain, quarterly earnings; UK, monthly earnings. † Average of latest 3 months compared with average of previous 3 months, at annual rate.

The Economist COMMODITY PRICE INDEX The London Metal Exchange has intervened to end a squeeze on the zinc market. The price of cash zinc has risen by nearly a quarter this year; and the premium paid for cash zinc over the price for metal to be delivered in three months' time widened to nearly $190 a tonne last week. The LME has set a limit of $15 a tonne (falling to $5 a tonne in July) on the premium for cash zinc. LME stocks of zinc have risen 80%, to 277,300 tonnes, since the beginning of the year, and producers hold another 300,000 tonnes. Since the market is heading for another surplus this year, prices should be lower. Consumers feel they have been the victims of speculators.

1985=100	Jun 9th	Jun 16th‡	% change on one month	% change on one year
Dollar index				
All items	112.1	111.8	+ 0.4	nil
Food	90.9	89.7	+ 0.7	+ 2.4
Industrials				
All	133.2	133.7	+ 0.2	− 1.6
Nfa ‡‡	127.1	128.5	+ 1.4	− 5.5
Metals	137.5	137.4	− 0.5	+ 1.2
Sterling index				
All items	78.4	77.0	− 0.6	−13.3
Food	63.6	61.8	− 0.3	−11.2
Industrials				
All	93.1	92.2	− 0.9	−14.7
Nfa ‡‡	88.9	88.5	+ 0.2	−18.1
Metals	96.2	94.7	− 1.6	−12.3
SDR index				
All items	80.9	80.3	− 0.2	− 7.5
Food	65.6	64.5	nil	− 5.2
Industrials				
All	96.1	96.1	− 0.4	− 8.9
Nfa ‡‡	91.7	92.4	+ 0.7	−12.5
Metals	99.2	98.8	− 1.2	− 6.3
Gold				
$ per oz	337.95	342.15	− 1.3	− 7.6
Crude oil North Sea Brent				
$ per barrel	21.08	21.08	+ 9.8	+14.9

‡ Provisional ‡‡ Non-food agriculturals

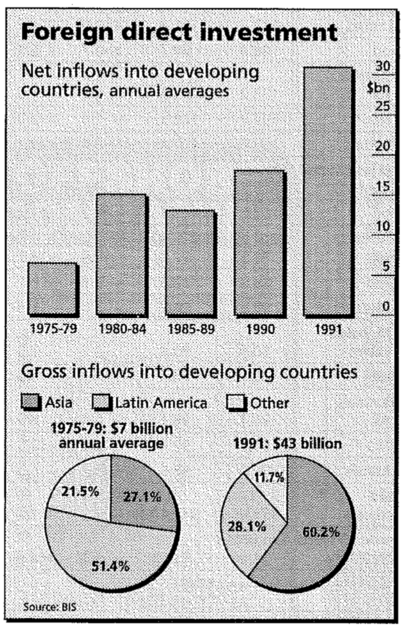
LONG-TERM GROWTH The chart, based on figures calculated by Angus Maddison, an economic historian, tracks the relative ranking of countries' GDP per head over time. In 1870 Britain was the world's richest country, with purchasing power per head more than twice that of Germany. By early this century it had been overtaken by America, and more recently it has been passed by all the other big industrial economies. Another country to slip behind is Argentina, which was almost as rich as Germany in 1870. Indeed, at its peak in the late 1920s Argentina was one of the richest countries in the world. Today it is somewhere around 70th. By contrast, Japan, which was little richer than India in 1870, has soared in the rankings in the past 40 years.



Footnotes applicable to all tables. All figures seasonally adjusted except * not seasonally adjusted. na not available. ††western Germany: consolidated figures for Germany not yet available.

ECONOMIC AND FINANCIAL INDICATORS 2

THIRD WORLD INVESTMENT While rich countries saw their inflows of foreign direct investment shrink by a fifth in 1991, developing countries took up some of the slack, according to the Bank for International Settlements. After averaging $13 billion a year from 1985 to 1989, and rising to $18 billion in 1990, net inflows of foreign direct investment into developing countries soared to $30.9 billion in 1991. The pattern changed too. In the late 1970s, when foreign investment in these countries averaged $7 billion a year, more than half of that cash went to Latin America, with another quarter heading for Asia. Last year, however, Asian countries accounted for 60.2% of gross inflows and Latin America for 28.1%. Other developing countries—mostly in Africa and Eastern Europe—accounted for just 11.7%, down from 21.5% in 1975-79.



WORLD BOURSES Most stockmarkets lost ground this week. Worst hit was Tokyo, which dropped 5% to under 17,000, on continuing worries over the economy. Johannesburg fell 2.8%, Paris 2.5% and Australia 2.1%. Milan slipped 2.3% to a new low for the year.

Stock price indices

	Jun 16th	1992 high	1992 low	% change on one week	one year	record high	Dec 31st 1991 in local currency	Dec 31st 1991 in $ terms
Australia	1639.4	1684.5	1545.3	− 2.1	+ 7.6	−28.9	− 0.7	− 1.6
Belgium	5882.6	5987.7	5494.9	− 1.3	+ 0.9	−13.6	+ 7.3	+ 3.7
Canada	3407.3	3666.0	3318.1	+ 0.6	− 4.0	−17.2	− 3.0	+ 8.4
France	526.4	555.9	475.5	− 2.5	+ 8.5	− 6.8	+10.4	− 6.6
Germany	1779.1	1811.6	1578.7	− 0.4	+ 4.9	− 9.6	+12.7	+ 9.1
Holland	214.3	215.5	192.4	− 0.6	+ 6.1	− 0.6	+12.0	+ 8.4
Hong Kong	5846.8	6082.7	4301.8	− 1.6	+ 60.7	− 3.9	+36.1	+36.9
Italy	468.8	551.6	468.8	− 2.3	− 23.4	−48.4	− 7.7	−10.6
Japan	16953.5	23801.2	16598.2	− 5.0	− 31.3	−56.4	−26.2	−27.3
Singapore	1519.9	1545.9	1352.8	+ 1.9	− 0.2	− 5.4	+ 2.0	+ 2.4
South Africa	4548.6	4689.0	4169.0	− 2.8	+ 20.1	− 3.0	+ 9.1	+ 5.1†
Spain	248.8	266.5	238.9	− 0.8	− 12.2	−24.4	+ 1.0	− 1.2
Sweden	950.1	1014.5	913.7	− 1.4	− 15.6	−30.8	+ 3.5	+ 1.5
Switzerland	1881.3	1963.7	1670.1	− 1.0	+ 9.1	− 4.2	+12.6	+ 8.4
UK	2616.3	2737.8	2382.7	− 0.7	+ 4.0	− 4.4	+ 4.9	+ 5.6
USA	3329.5	3413.2	3172.4	− 1.2	+ 11.5	− 2.5	+ 5.1	+ 5.1
World‡	500.9	542.1	467.5	− 1.0	+ 1.0	−12.3	− 6.1	− 6.1

‡ Morgan Stanley Capital International † Converted at financial rate.

MONEY AND INTEREST RATES America's narrow money supply grew by 12.2% in the year to May; its broad money edged up by only 0.1%. Spain's broad-money growth slowed to 6.5% in the same period; its narrow-money growth quickened to 8.0%.

	money supply‡ % rise on year ago: narrow [M1]	broad	interest rates % p.a. (Jun 16th 1992) money market: overnight	3 months	commercial banks: prime lending	deposits 3 months	bond yields: gov't long-term	corporate	eurocurrency: deposits 3 months	bonds
Australia	+15.4	+ 3.3 Apr	6.30	6.05	10.75	6.05	9.03	9.99	6.06	8.53*
Belgium	+ 7.0	+ 7.7 Q3	9.30	9.56	13.25	9.56	9.10	9.39	9.56	8.94
Canada	+ 3.8	+ 4.8 May	6.13	5.69	7.25	5.75	8.91	10.07	5.69	8.05
France	− 2.0	+ 3.6 Apr	9.94	10.06	9.85	10.00	8.76	9.38	10.06	8.88
Germany	na	+ 7.5 Apr	9.60	9.65	11.00	8.78	8.35	8.44	9.69	8.26
Holland	+ 2.9	+ 5.2 Mar	9.22	9.47	11.75	9.47	8.29	9.13	9.50	8.46
Italy	+ 9.3	+ 8.0 Apr	13.13	14.00	13.50	na	11.44	11.52	13.38	11.59
Japan	+ 7.4	+ 1.6 Apr	4.72	4.61	5.25	2.15	5.48	5.83	4.59	5.53
Spain	+ 8.0	+ 6.5 May	12.47	12.64	13.00	8.00	11.64	12.57	12.50	11.27
Sweden	na	+ 4.5 Apr	11.55	11.69	12.50	11.80	9.70	12.36	11.25	10.16
Switzerland	+ 1.8	+ 2.9 Mar	9.00	9.19	11.38	8.69	6.88	7.29	9.25	6.94
UK	+ 2.3	+ 5.7 Apr	10.63	10.00	11.00	10.00	9.09	10.27	9.98	9.43
USA	+12.2	+ 0.1 May	3.74	3.93	6.50	3.86	7.83	8.47	3.88	7.00

Other key rates in London 3-mth Treasury Bills 9.5%, 7-day Interbank 10.4%, clearing banks' 7-day notice 4.0%. Eurodollar rates (Libor): 3 mths 3.9%, 6 mths 4.1%.

‡ M1 except UK M0; M3 except Belgium, Holland, Italy and Sweden M2, Japan M2 plus CDs, Spain M3 plus other liquid assets, UK M4. Definitions of interest rates quoted available on request. Sources: Banco Bilbao Vizcaya, Chase Manhattan, Banque de Commerce (Belgium), Credit Lyonnais, Bank Nederland, Royal Bank of Canada, Svenska Handelsbanken, Westpac Banking Corp, CSFB, The WEFA Group. These rates cannot be construed as offers by these banks. * New Series

TRADE, EXCHANGE RATES AND RESERVES America's current-account deficit widened to $21.2 billion in the year to the first quarter. Germany's visible-trade surplus widened to $3.1 billion in April, bringing its 12-month surplus to $15.4 billion. In the same period, Germany's current-account deficit shrank slightly, to $20.1 billion. This week's table shows new figures for reserves.

	trade balance‡ $bn latest month	latest 12 months	current-account balance $bn latest 12 mths	trade-weighted‡‡ exchange rate 1985=100 latest	year ago	currency units per $ latest	year ago	currency units per £	per SDR	per ecu	foreign reserves†† $bn Apr	year ago
Australia	+ 0.33 Apr	+ 3.6	− 9.2 Apr	83.4	88.6	1.33	1.31	2.46	1.88	1.73	13.6	15.6
Belgium	− 0.78 Feb	− 3.3	+ 4.6 Q4	111.8	109.9	32.4	37.4	60.1	45.7	42.2	11.4	10.5
Canada	+ 0.75 Mar	+ 6.8	− 23.4 Q4	99.2	107.3	1.20	1.14	2.22	1.69	1.56	14.9	15.8
France	+ 1.40 Apr	+ 0.2	− 5.5 Q4	105.0	101.1	5.28	6.16	9.82	7.45	6.90	32.9*	36.1
Germany	+ 3.09 Apr	+ 15.4	− 20.1 Apr	119.1	115.6	1.57	1.81	2.92	2.22	2.05	63.2	59.7
Holland	− 0.11 Mar	+ 7.3	+ 9.4 Q4	114.7	112.4	1.77	2.04	3.29	2.50	2.31	16.8	16.0
Italy	− 1.37 Apr	− 13.6	− 21.5 Q4	98.4	97.8	1186	1349	2207	1674	1552	39.5	59.5
Japan	+ 9.33 Apr	+115.2	+ 92.1 Apr	141.7	136.9	127	141	236	179	165	71.1	66.8
Spain	− 3.00 Apr	− 34.3	− 19.1 Apr	107.8	105.7	98.9	114	184	140	129	66.7	54.4
Sweden	+ 0.32 Apr	+ 6.3	− 3.3 Mar	96.0	92.9	5.65	6.56	10.5	7.98	7.41	22.2*	18.2
Switzerland	− 0.04 Apr	− 3.7	+ 9.1 Q4	107.6	110.0	1.41	1.56	2.62	1.99	1.85	26.6	25.4
UK	− 2.39 Apr	− 18.6	− 9.0 Apr	92.8	89.3	0.54	0.62	—	0.76	0.70	40.9	38.5
USA	− 5.82 Mar	− 63.2	− 21.2 Q1	62.3	68.5	—	—	1.86	1.41	1.30	63.7	67.2

‡ Australia, France, Canada, Japan, UK and USA imports fob, exports fob. All others cif/fob. ‡‡ Bank of England, Reserve Bank of Australia indices. †† Excluding gold. * March

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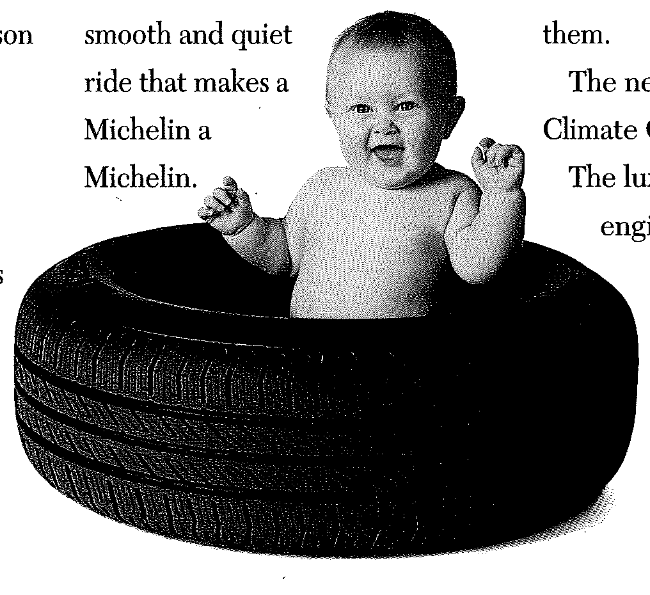

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